TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1933

No. 44

JOHN T. DOBSON, PETITIONER,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

No. 45

E. W. DOBSON, PETITIONER,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

No. 46

ESTATE OF JAMES N. COLLINS, DECEASED, SECURITY NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, EXECUTOR, PETITIONER,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

No. 47

E. J. HARWICK, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

IN THREE CASES BEFORE THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

PETITIONS FOR CERTIORARI FILED APRIL 24, 1934.

CERTIORARI GRANTED JUNE 4, 1934.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1943

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vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

No. 45

E. W. DOBSON, PETITIONER,

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GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

No. 46

ESTATE OF JAMES N. COLLINS, DECEASED, FIRST NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, EXECUTOR, PETITIONER,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

No. 47

H. J. HARWICK, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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[fol. a] [Caption omitted]

[fol. 1]

BEFORE UNITED STATES BOARD OF TAX APPEALS

DOCKET ENTRIES

Docket No. 105790

H. J. HARWICK, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Appearances:

For Taxpayer: Leland W. Scott, John W. Windhorst.
For Comm'r: S. U. Hiken, Esq.

1940

Dec. 5—Petition received and filed. Taxpayer notified. (Fee paid).
Dec. 5—Copy of petition served on General Counsel.
Dec. 5—Request for circuit hearing in St. Paul, Minn., filed by taxpayer. 12/5/40 copy served.

1941

Jan. 27—Answer filed by General Counsel.
Jan. 30—Copy of answer served on taxpayer. (St. Paul, Minn.)
Apr. 28—Hearing set 6/16/41 (St. Paul, Minn.).
June 18—Hearing had before Mr. Turner on the merits. Submitted. Stipulation as to the facts filed. Brief due Aug. 2, 1941; Reply briefs Aug. 18, 1941.
July 25—Brief filed by taxpayer.
Aug. 2—Transcript of hearing 6/18/41 filed.
Aug. 2—Brief filed by General Counsel.
Aug. 4—Copy of brief served on General Counsel.

[fol. 2]

1942

Mar. 30—Memorandum opinion rendered, Turner, Div. 8. Decision will be entered under Rule 50. 3/30/42 copy served.

Apr. 17—Agree computation filed.
Apr. 23—Decision entered, Murdock, Div. 3.
July 20—Petition for review by United States Circuit Court of Appeals, Eighth Circuit, with assignments of error filed by taxpayer.
July 22—Proof of service filed.
Aug. 6—Agreed praecipe for transcript filed.

Petition of H. J. Harwick

Docket No. 105790

H. J. Harwick, Petitioner,

vs.

Commissioner of Internal Revenue, Respondent

Petition of H. J. Harwick

(Received and Filed December 5, 1942)

The above named Petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his Notice of Deficiency dated October 21, 1940, and as a basis for the proceeding alleges as follows:

I

The Petitioner, H. J. Harwick, is an individual residing in the City of Rochester, County of Olmsted, State of Minnesota. On or about March 15, 1940, Petitioner filed an income tax return for the calendar year 1939 with the Collector of Internal Revenue of the United States in and for the District of Minnesota.

II

The Notice of Deficiency, a copy of which, marked Exhibit [fol. 3] A, is attached hereto and hereby made a part hereof, was mailed to Petitioner on October 21, 1940. The taxes in controversy are income taxes for the calendar year 1939 asserted against the Petitioner by said notice.

III

Said Notice of Deficiency determined that Petitioner's income tax liability for the calendar year 1939 was $38,272.72.

Of this amount $33,643.71 was paid by Petitioner during the calendar year 1940 and in addition $221.25 was paid on September 12, 1940. Respondent determined a deficiency in Petitioner's income tax liability for the calendar year 1939 in the sum of $4,629.01. The entire amount of said deficiency is in controversy.

IV

The determination of tax set forth in said Notice of Deficiency is based on the following errors:

(a) Respondent erred in determining that the entire amount of $17,000 recovered by Petitioner during the calendar year 1939 from National City Company constituted income taxable to Petitioner.

(b) Respondent erred in determining that $7,115.78 of said $17,000 received by Petitioner from National City Company did not constitute a return of capital to the Petitioner.

(c) Respondent erred in determining that Petitioner realized income in excess of the sum of $9,884.22 as a result of the recovery by Petitioner of said $17,000 from said National City Company.

(d) Respondent erred in determining that the income realized by Petitioner as a result of said recovery from National City Company did not constitute capital gain under the provisions of Section 117 of the Internal Revenue Code.

(e) Respondent erred in determining that there is a deficiency in Petitioner's income tax liability for the calendar year 1939.

V

The facts upon which Petitioner relies as a basis for this proceeding are as follows:

[fol. 4] (a) On or about July 22, 1929, the Petitioner purchased stock of National City Bank of New York from the National City Company for the sum of $38,100. On or about December 15, 1931, the Petitioner sold said stock for the sum of $3,648.72. The Petitioner thereby sustained a loss in the sum of $34,451.28. On or about March 15, 1932, Petitioner filed an income tax return for the calendar year

1931 with the Collector of Internal Revenue of the United States in and for the District of Minnesota. A true and correct copy of said return, marked Exhibit B, is attached hereto and hereby made a part hereof. The income deductions and credits set forth therein are true and correct and respondent has not made any changes therein.

(b) During the calendar year 1939 the Petitioner instituted suit against the National City Company for the recovery of the purchase price of said stock of the National City Bank of New York purchased from said National City Company on July 22, 1929, as set forth in paragraph V (a) above. Said suit was dismissed and Petitioner received as consideration for said dismissal the net amount of $17,000. Except for said recovery of $17,000 during the calendar year 1939 Petitioner has not been reimbursed in any manner for the loss sustained on the sale of said stock of National City Bank of New York realized upon sale thereof on December 15, 1931, as set forth in paragraph V (a) above.

Wherefore, Petitioner prays that this Board may hear the proceeding and decide that:

(a) Respondent erred in determining that the entire amount of $17,000 recovered by Petitioner during the calendar year 1939 from National City Company constituted income taxable to Petitioner.

(b) Respondent erred in determining that $7,115.78 of said $17,000 received by Petitioner from National City Company did not constitute a return of capital to the Petitioner.

(c) Respondent erred in determining that Petitioner realized income in excess of the sum of $9,884.22 as a result of the recovery by Petitioner of said $17,000 from said National City Company.

[fol. 5] (d) Respondent erred in determining that the income realized by Petitioner as a result of said recovery from National City Company did not constitute capital gain under the provisions of Section 117 of the Internal Revenue Code.

(e) Respondent erred in determining that there is a deficiency in Petitioner's income tax liability for the calendar year 1939.

Leland W. Scott, John W. Windhorst, 1300 First National-Soo Line Bldg., Minneapolis, Minnesota. Attorneys for Petitioner.

Duly sworn to by H. J. Hardwick. Jurat omitted in printing.

EXHIBIT "A" TO PETITION

Form 1230 SN-IT 1

Office of Internal Revenue Agent in Charge, St. Paul Division, 800 Post Office Bldg.

Treasury Department, Internal Revenue Service

St. Paul, Minnesota

[fol. 6] Oct. 21, 1940.

Collection District: Minnesota.

Mr. H. J. Harwick, c/o Mayo Clinic, Rochester, Minnesota

SIR:

You are advised that the determination of your income tax liability for the taxable year 1939 discloses a deficiency of $4,629.01 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the internal revenue agent in charge, St. Paul, Minnesota, for the attention of LGE-90D. The signing and filing of this form will

expedite the closing of your return(s) by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully, Guy T. Helvering, Commissioner, by C. W. Rink, Internal Revenue Agent in Charge.

Enclosures: Statement. Form of waiver.
LGE/mrr.

GPO 2—17679

[fol. 7]

STATEMENT

Mr. H. J. Harwick,

c/o Mayo Clinic,

Rochester, Minnesota

Tax Liability for Taxable Year ended December 31, 1939

	Liability	Assessed	Deficiency
Income tax	$38,272.72	$33,643.71	$4,629.01

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated July 10, 1940, to your protest dated September 3, 1940, and to statements made at conference held on October 7, 1940.

A copy of this letter and statement has been mailed to Leland W. Scott, 1300 First National Soo Line Building, Minneapolis, Minnesota, in accordance with the power of attorney executed by you.

Adjustments to Net Income

Net income as disclosed by return		$102,024.36
Unallowable deductions and additional income:		
(a) Trustees fees	$375.00	
(b) Recovery	7,115.78	7,490.78
Net income adjusted		109,515.14

Explanation of Adjustments

(a) This represents the inclusion in income of trustees' fees received from the First National Bank and Trust Company, co-trustee of Mayo Living Trust #2075.

(b) In 1939 you recovered $17,000.00 from the National City Bank in connection with your acquisition and sale of that stock in a prior year. This recovery constitutes gross income 100% taxable within the meaning of section 22(a) of the Internal Revenue Code. Accordingly that portion of the recovery not reported in your return is included herewith as taxable income as shown below:

[fol. 8] Total recovery	$17,000.00
Portion of recovery reported	9,884.22
Adjustment	7,115.78

Computation of Tax

Net income adjusted		$109,515.14
Less: Personal exemption	$2,500.00	
Credit for dependents	33.33	2,533.33
Balance (surtax net income)		106,981.81
Less: Earned income credit (10% of $14,000.00)		1,400.00
Net income subject to normal tax		105,581.81
Normal tax at 4% on $105,581.81		4,223.27
Surtax on $106,981.81		34,049.45
Total tax		38,272.72
Income tax assessed: Original, Account No. 200675		33,643.71
Deficiency of income tax		4,629.01

For Exhibit "B"

See Exhibit "B" attached to Stip Facts

United States Board of Tax Appeals

Docket No. 105790

H. J. HARWICK, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

ANSWER OF COMMISSSIONER OF INTERNAL REVENUE

(Received and Filed January 27, 1941)

[fol. 9] Now comes the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed herein admits and denies as follows:

I. Admits the allegations contained in paragraph I of the petition.

II. Admits the allegations contained in paragraph II of the petition except it is denied that the entire amount of the deficiency asserted in the deficiency notice is in controversy.

III. Admits that in the notice of deficiency it was determined that petitioner's income tax liability for the calendar year 1939 was $38,272.72; admits that respondent determined a deficiency in petitioner's income tax liability for the calendar year 1939 in the sum of $4,629.01; denies the remaining allegations contained in paragraph III of the petition.

IV. (a) to (e), inclusive. Denies that the respondent erred as alleged in subparagraphs (a) to (e), inclusive, of paragraph IV of the petition.

V. (a) Admits that on or about July 22, 1929, the petitioner purchased stock of National City Bank of New York for the sum of $38,100.00; admits that on or about December 15, 1931, the petitioner sold said stock for the sum of $3,648.72; admits that the petitioner thereby sustained a loss in the sum of $34,451.28; denies the remaining allega-

tions contained in subparagraph (a) of paragraph V of the petition.

V. (b) Denies the allegations contained in subparagraph (b) of paragraph V of the petition, except it is admitted that petitioner received $17,000.00 during 1939.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore specifically admitted, qualified or denied.

Wherefore, respondent prays that the Board redetermine the deficiency herein to be the amount determined by the Commissioner, viz.: $4,629.01 in respect of income taxes for [fol. 10] the taxable year 1939.

J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue.

Of Counsel: F. R. Shearer, Division Counsel, S. U. Hiken, Special Attorney, Bureau of Internal Revenue.

UNITED STATES BOARD OF TAX APPEALS

Docket No. 105790

H. J. HARWICK, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

John W. Windhorst, Esq., and Leland W. Scott, Esq., for the petitioner.

S. U. Hiken, Esq., for the respondent.

OPINION

Turner: The respondent determined a deficiency in income tax for the year 1939 in the amount of $4,629.01. The question presented is whether a sum of money, or any part thereof, recovered by the petitioner in the taxable year as the result of a claim asserted against the National City Company of New York and arising out of a certain stock transaction in a prior year constitutes a return of capital, as contended by petitioner, or taxable income, as contended by the respondent. The parties have filed a written stipulation of facts with certain exhibits attached thereto and the

Board adopts such stipulation as its findings of fact. We shall recite only the facts deemed necessary to discussion of the issues presented.

Petitioner, a resident of Rochester, Minnesota, filed his 1939 income tax return with the collector of internal revenue for the district of Minnesota.

On July 22, 1929, the petitioner purchased, in a transaction entered into for profit, 100 shares of the capital stock of the National City Bank of New York. The stock also carried certain beneficial interests in the stock of the Na- [fol. 11] tional City Company of New York. The purchase was made in the State of Minnesota from the National City Company, the consideration being $38,000.

On December 15, 1931, petitioner sold the 100 shares of stock and sustained a loss by reason of said sale in the amount of $34,451.28. This loss was claimed as a deduction by the petitioner in his 1931 income tax return and was allowed by the respondent.

Until the early part of 1938 petitioner regarded the aforesaid purchase and sale as a closed and completed transaction. At that time he learned that other individuals who had purchased National City Bank stock in Minnesota from the National City Company had filed legal actions to recover the amounts paid by them for the stock on the ground that it had been sold without having been registered in accordance with the requirements of the Minnesota Blue Sky laws and on the ground that the sales had been fraudulent. After petitioner learned of these facts, and on or about January 10, 1939, he asserted a claim against the National City Company. On March 7, 1939, the claim was settled by a net payment of $17,000 by the company to petitioner, and upon receipt thereof, petitioner executed an instrument releasing the National City Company from all claims, demands, or causes of action which he ever had against it.

In his income tax return for 1939, the petitioner reported income of only $9,884.22 on account of the recovery of the $17,000. In the deficiency notice the respondent adjusted the amount of income reported by adding thereto $7,115.78, thereby treating the entire amount of petitioner's net recovery of $17,000 as gross income, taxable as ordinary gain. If the entire deduction of $34,451.28, claimed and allowed on petitioner's 1931 income tax return, had been disallowed, a deficiency in petitioner's income tax liability for 1931

would have resulted in the amount of $3,349.53, computed as follows:

Net income per return		$12,042.03
Add: Loss on sale of National City Bank stock		34,451.28
Net income revised		46,493.31

[fol. 12]

Less: Dividends	$11,861.81	
Personal exemption	3,500.00	
Credit for dependents	800.00	16,161.81
Balance subject to normal tax		$30,331.50
Normal tax:		
1-½% of first $4,000.00		60.00
3% of next $4,000.00		120.00
5% of $22,331.50		1,116.58
Total normal tax		$1,296.58
Surtax on $46,493.31		2,539.20
Total		$3,835.78
Less: Earned income credit		486.25
Total tax assessable		$3,349.53
Assessed		None
Deficiency		$3,349.53

If the petitioner had received $7,115.78 on the sale of the stock in 1931, in addition to the amount actually received, his deductible loss for 1931 from the sale of the said stock would have been $27,335.50 instead of $34,451.28, and he would have had net income in the amount of $19,157.81. Due to certain credits allowable, however, his income tax for 1931 would have been zero, shown as follows:

Net income shown in original return	$12,042.03
Add:	
Amount recovered in 1939 and not reported as taxable income for 1939	7,115.78
Net income revised	$19,157.81

Less: Dividends	$11,861.81	
Personal exemption	3,500.00	
Credit for dependents	800.00	16,161.81
Balance subject to normal tax		$ 2,996.00

[fol. 13]

Normal tax at 1-½%	44.94
Surtax on $19,157.81	186.30
Tax on net income	$ 231.24
Less earned income credit	231.24
Total tax assessable	00.00
Tax assessed	None
Deficiency	None

Throughout the year 1939 adjustment of petitioner's income tax liability for 1931 was barred by the statute of limitations.

Petitioner contends that the amount recovered in 1939 is in the nature of a capital recovery, and that it constitutes taxable income only to the extent that the loss deduction taken in 1931 resulted in a "tax benefit" to him. Of the total net recovery of $17,000, petitioner admits that to the extent of $9,884.22 he realized a "tax benefit" from the deduction taken in 1931, and concedes that to that extent the recovery constitutes taxable income for 1939. He contends, however, that the remaining $7,115.78 was of no "tax benefit" to him in 1931 and not therefore taxable income in 1939, since that amount could have been added to his gross income for 1931 without resulting in any income tax liability for such year. Petitioner also contends that if any portion of the recovery is taxable to him in 1939 it is taxable as capital gain. The respondent contends that the entire amount recovered in 1939 is taxable as ordinary gain and that it is wholly immaterial whether he realized any "tax benefit" from the deduction taken in 1931, but that in any event he realized a "tax benefit" to the full extent of the recovery, since the full amount of the deduction taken in 1931 did effect an offset of taxable income.

We have considered this same question in the case of Estate of James N. Collins, 46 B. T. A. ——— (March 27,

1942), and in that case we held that since the deduction claimed by the taxpayer in the prior year did not effect an offset of taxable income, the subsequent recovery in the taxable year did not constitute taxable income. In John V. Dobson, 46 B. T. A. —— (March 27, 1942), however, we [fol. 14] held that where recovery was had in a later year in respect of such loss the amount recovered was taxable income in the year of recovery to the extent that the deduction in the prior year of the amount later recovered had effected an offset of taxable income in such prior year. In the instant case the facts show that in 1931 petitioner was allowed a loss deduction of $34,451.28 on account of the sale of the bank stock and after taking such deduction he still had net income of $12,042.03. It appears therefore that the full amount of the deduction claimed in 1931 did effect an offset of taxable income. Accordingly the full amount recovered in 1939 is taxable income for that year. John V. Dobson, supra; National Bank of Commerce of Seattle v. Commissioner, 115 Fed. (2d) 875, affirming 40 B. T. A. 72; Central Loan and Investment Co., 39 B. T. A. 981; and Amsco-Wire Products Corporation, 44 B. T. A. 717.

Petitioner's contention that such income should be taxed as capital gain is denied on authority of Avery R. Schiller, 43 B. T. A. 594.

Decision will be entered under Rule 50.

Entered: March 30, 1942.

(Seal) U. S. Board of Tax Appeals, 1924.

UNITED STATES BOARD OF TAX APPEALS, WASHINGTON

Docket No. 105790

H. J. HARWICK, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

ORDER OF REDETERMINATION

Pursuant to the Memorandum Opinion of the Board entered March 30, 1942, the parties herein having on April 17, [fol. 15] 1942, filed an agreed recomputation of tax in accordance therewith, it is

Ordered and Decided: That there is a deficiency in income tax for the year 1939 in the amount of $4,629.01.

Enter: Entered April 23, 1942.

J. E. Murdock, Member.

(Seal) U. S. Board of Tax Appeals, 1924.

UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT

B. T. A. Docket No. 105790

H. J. HARWICK, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

PETITION OF H. J. HARWICK FOR REVIEW OF DECISION OF UNITED STATES BOARD OF TAX APPEALS—Filed July 20, 1042.

To The Honorable Judges of The United States Circuit Court of Appeals for the Eighth Circuit:

Now comes H. J. Harwick, by his attorneys, Leland W. Scott and John W. Windhorst, and respectfully shows:

I

JURISDICTION

The petitioner on review is an individual residing in the City of Rochester, County of Olmsted, State of Minnesota. The respondent on review holds his office under and by virtue of the laws of the United States. An income tax return was filed by the petitioner for the calendar year 1939 on or about March 15, 1940, with the Collector of Internal [fol. 16] Revenue for the District of Minnesota in St. Paul, Minnesota, whose office is located within the judicial district of the United States Circuit Court of Appeals for the Eighth Circuit.

II

NATURE OF CONTROVERSY

On October 21, 1940, the Respondent forwarded to the Petitioner by registered mail a notice of deficiency wherein the Petitioner was notified of a deficiency in the amount of $4,629.01 in his income tax liability for the year 1939.

Thereafter, on December 5, 1940, the Petitioner filed with the Board of Tax Appeals a petition for redetermination of the proposed deficiency for the year 1939. On January 27, 1941, the Commissioner filed with the Board of Tax Appeals his answer to the petition. The proceeding came on to be heard before a division of the Board of Tax Appeals sitting in St. Paul, Minnesota, on June 18, 1941.

The questions presented are (1) whether the Petitioner must include in his taxable gross income for the calendar year 1939 the amount of $7,115.78, representing a portion of the $17,000 received from National City Company in settlement of claim for rescission of a purchase of stock of National City Bank of New York under the Minnesota Blue Sky Law by the Petitioner and excluded by the Petitioner from income reported in his return and (2) whether the amount of said recovery which may be determined to constitute taxable income, including the portion which Petitioner concedes to be taxable, viz., $9,884.22, is taxable as ordinary income or as capital gain under Section 117 of the Internal Revenue Code.

On March 30, 1942, the Board of Tax Appeals promulgated its opinion wherein it was held that the Petitioner was taxable on the entire amount of $17,000 received in settlement of his claim against National City Company in 1939, including the sum of $7,115.78 which was excluded by the Petitioner from the taxable income reported in his return for 1939. The Board further held that said $17,000 was taxable as ordinary income rather than capital gain. On April 23, 1942, the Board entered its decision and [fol. 17] order that there was a deficiency of $4,629.01 in the Petitioner's income tax liability for the calendar year 1939. On or about April 14, 1942, the Petitioner paid the balance then owing of said deficiency, being $4,407.76, plus interest in the amount of $550.97, to the Collector of Internal Revenue for the District of Minnesota.

The facts, shortly stated, are as follows: On July 22, 1929, the Petitioner purchased from National City Company 100 shares of capital stock in the National City Bank of New York at a cost of $38,000. On December 15, 1931, Petitioner sold these shares for $3,648.72, sustaining a loss of $34,451.28, which amount was allowed by the Commissioner as a deduction in determining the Petitioner's income tax liability for that year. In 1938 Petitioner made a claim against the National City Company that he was entitled to

rescind the purchase of stock in 1929 and to recover the purchase price paid therefor. During the year 1939 this claim was compromised by the payment to Petitioner by National City Company of $17,000. Of this amount $7,115.78 was not included in the Petitioner's 1939 income tax return. The balance of $9,884.22 was included in Petitioner's 1939 income tax return as ordinary income and not as capital gain and a tax was paid thereon. If Petitioner's loss realized upon sale of said stock of National City Bank of New York in 1931 had been reduced by the amount of $7,115.78, his net income for 1931 Federal income tax purposes would have been $19,157.81. Due to deductions for personal exemption, credits for dependents, and the earned income credit, his income tax for 1931 on a net income of $19,157.81 would have been zero. The loss on the sale of said stock of National City Bank of New York in 1931 resulted in no tax saving to the Petitioner to the extent of $7,115.78.

III

Points on Which Petitioner Intends to Rely

Petitioner is aggrieved at the decision of the Board of Tax Appeals and says that in the proceeding before the Board and in the opinion and decision aforesaid manifest error occurred and intervened to his prejudice and he assigns as error the following:

[fol. 18] 1. The Board of Tax Appeals erred in determining that there was a deficiency in Petitioner's income tax liability for 1939 and in failing to order a refund to Petitioner for said year in the sum of $2,914.84, in that its decision is contrary to law.

2. The Board of Tax Appeals erred in finding that any part of the amount received in settlement of the legal claim against the National City Company in 1939 in excess of $9,884.22 was [includable] in the Petitioner's taxable income for the calendar year 1939, under Section 22 of the Internal Revenue Code.

3. The Board of Tax Appeals erred in finding that any part of the amount received in settlement of the claim against the National City Company in 1939 was to be treated as ordinary income rather than capital gain under Section 117 of the Internal Revenue Code.

4. The Board of Tax Appeals erred in failing to find that the said amount of $9,884.22 reported by Petitioner as ordinary income in his return for 1938 was taxable as capital gain under Section 117 of the Internal Revenue Code.

5. The Board of Tax Appeals erred in failing to find that none of the amount recovered in settlement of the legal claim against the National City Company in 1939 in excess of $9,884.22 was [includable] in the taxable income of the Petitioner in 1939, under Section 22 of the Internal Revenue Code.

6. The Board of Tax Appeals erred in entering judgment that there was a deficiency of $4,629.01 in the amount of the Petitioner's income tax liability for the calendar year 1939, instead of entering judgment of no deficiency for said year, together with a judgment for a refund to the Petitioner for said year in the sum of $2,914.84, in that the uncontradicted evidence warrants no other conclusion.

Wherefore, The Petitioner requests that the aforesaid decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Eighth Circuit; that a transcript of record be prepared in accordance with law and the rules of this Court and transmitted to the Clerk of said Court for filing; and that appropriate [fol. 19] action be taken, to the end that errors complained of may be reviewed and corrected by the Court.

Leland W. Scott, John W. Windhorst, Counsel for Petitioner, 1300 First National-Soo Line Building, Minneapolis, Minnesota.

Duly sworn to by John W. Windhorst, jurat omitted in printing.

* * * * * * *

In United States Circuit Court of Appeals

Notice of filing of Petition for Review and Service.

(Received and Filed July 22, 1942, United States Board of Tax Appeals.)

To: J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue.

You are hereby notified that H. J. Harwick did, on the 20th day of July, 1942, file with the Clerk of the United

States Board of Tax Appeals, at Washington, D. C., a [fol. 20] petition for review by the United States Circuit Court of Appeals for the Eighth Circuit, of the decision of the Board heretofore rendered in the above entitled case. Copy of the petition for review as filed is hereto attached and served upon you.

Dated this 21st day of July 1942.

B. D. Gamble, Clerk, U. S. Board of Tax Appeals.

Service of copy of Petition for Review acknowledged this 22nd July 1942.

J. P. Wenchel, Attorney for Respondent.

UNITED STATES BOARD OF TAX APPEALS

Docket No. 105790

H. J. HARWICK, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

STIPULATION OF FACTS—Filed at Hearing June 18, 1941

It is hereby stipulated and agreed by and between the parties hereto, by their respective counsel, that the following facts shall be taken as true, provided, however, (1) that each of the parties hereto reserves the right to object to the admissibility in evidence of any of such facts, on the ground of irrelevancy and immateriality, and (2) that this stipulation shall be without prejudice to the right of either party to introduce other and further evidence not inconsistent herewith:

1. Petitioner, a resident of Rochester, Minnesota, filed, within the time required by law, his 1939 Federal income tax return with the Collector of Internal Revenue at St. Paul, Minnesota.

2. On July 22, 1929, Petitioner, in a transaction entered [fol. 21] into for profit, purchased in the State of Minnesota from the National City Company (of New York) 100

shares of the capital stock of National City Bank (hereinafter referred to as the stock) for $38,000, the purchase carrying with it, at no additional cost, a proportionate beneficial interest in the capital stock of National City Company (of New York). In June, 1933, the name of National City Company (of New York) was changed to City Company of New York, Inc.

3. On December 15, 1931, Petitioner sold the stock together with said beneficial interest in the capital stock of National City Company (of New York) for $3,648.72, thereby sustaining a loss of $34,451.28. This loss, which the Petitioner claimed as a deduction from gross income in his Federal income tax return for 1931, was allowed as a deduction by the Respondent.

4. From 1931 until the early part of 1938 the Petitioner regarded the aforesaid purchase and sale as a closed and completed transaction. In the early part of 1938, however, he learned that other individuals who had purchased National City Bank stock in Minnesota from the National City Company had filed legal actions to recover the amounts paid by them on the ground that the stock had been sold without having been registered in accordance with the requirements of the Minnesota Blue Sky laws and on the grounds that said sales had been fraudulent. After Petitioner made this discovery, and on or about January 10, 1939, he asserted a claim against the National City Company which was settled on March 7, 1939. The net amount which the petitioner received on such settlement, after paying attorneys fees and other similar expenses, was $17,000.00. A copy of the release which the Petitioner executed on such settlement is attached hereto, marked Exhibit A, and made a part hereof the same as if fully set forth herein.

5. In his Federal income tax return for 1939 the Petitioner reported income of only $9,884.22 on account of the receipt of $17,000.00 as aforesaid. In the deficiency notice from which the appeal herein was taken the Respondent adjusted the amount of income reported by the petitioner on said recovery by adding $7,115.78 thereto, thereby treating the entire amount of petitioner's net recovery of $17,000.00 as gross income, 100% taxable to the petitioner.

[fol. 22] 6. If the entire deduction of $34,451.28 which was claimed and allowed on Petitioner's 1931 Federal income tax return (paragraph 3, hereof, supra) had been disallowed, a deficiency in petitioner's Federal income tax liability for 1931 would have resulted in the amount of $3,349.53, computed as follows:

Net income per return		$12,042.03
Add: Loss on sale of National City Bank stock		34,451.28
Net income revised		$46,493.31
Less: Dividends	$11,861.81	
Personal exemption	3,500.00	
Credit for dependents	800.00	16,161.81
Balance subject to normal tax		$30,331.50
Normal tax:		
1½% of first $4,000.00		60.00
3% of next $4,000.00		120.00
5% of $22,331.50		1,116.58
Total normal tax		$ 1,296.58
Surtax on $46,493.31		2,539.20
Total		$ 3,835.78
Less: earned income credit		486.25
Total tax assessable		$ 3,349.53
Assessed		None
Deficiency		$ 3,349.53

Assessment of this deficiency was barred by statute of limitations throughout the year 1939.

7. If petitioner had received $7,115.78 on the sale of the stock in 1931 in addition to the $3,648.72 which he did receive (paragraph 3, hereof, supra,) his 1931 loss would have been $27,335.50 instead of $34,451.28, and his Federal income tax liability for 1931 would have been zero, computed as follows:

[fol. 23] 1931

Net income shown in original return		$12,042.03
Add:		
Amount recovered in 1939 and not report- as taxable income for 1939		7,115.78
Net income revised		$19,157.81
Less: Dividends	$11,861.81	
Personal exemption	3,500.00	
Credit for dependents	800.00	16,161.81
Balance subject to normal tax		$ 2,996.00
Normal tax at 1½%		44.94
Surtax on $19,157.81		186.30
Tax on net income		$ 231.24
Less earned income credit		231.24
Total tax assessable		00.00
Tax assessed		None
Deficiency		None

8. Photostats of the petitioner's Federal income tax returns for the years 1931 and 1939 are attached hereto, marked Exhibits B and C, respectively, and made a part hereof the same as if fully set forth herein. The income, deductions, and credits set forth in said return for the year 1931 are true and correct and Respondent has made no change therein upon audit of said return.

9. In the deficiency notice from which the appeal herein was taken the respondent disallowed a deduction designated as "trustee's fees," in the amount of $375.00, which the petitioner concedes to be correct.

10. Prior to the issuance of the deficiency notice herein the petitioner made a voluntary payment on account of his income tax liability for 1939 in the amount of $221.25.

This payment, which has not been assessed, is held in the suspense account of the Collector of Internal Revenue for [fol. 24] the District of Minnesota. The deficiency in Petitioner's income tax liability for 1939 which is asserted in the deficiency notice from which the appeal herein was taken is $4,629.01, but in view of said voluntary payment the amount of the deficiency in controversy is $4,401.12.

Leland W. Scott, John W. Windhorst, Counsel for Petitioner. J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, Counsel for Respondent.

EXHIBIT "A" TO STIPULATION

Receipt and Release

For and in consideration of the sum of One Dollar ($1.00) and other good and valuable consideration, to me in hand paid by The City Company of New York, Incorporated, formerly The National City Company, I hereby release, discharge, and forever acquit said corporation, its subsidiaries and affiliates, and The National City Bank of New York and City Bank Farmers Trust Company, from all claims, demands, or causes of action which I ever had or now have against them, or any of them, arising directly or indirectly from any purchase whatsover from or any sale whatsoever by The National City Company or The City Company of New York, Incorporated, of stock or rights to subscribe to stock of The National City Bank of New York, or from subscriptions thereto, including any accompanying interest in the stock of The National City Company, The City Company of New York, Incorporated, or City Bank Farmers Trust Company.

In Witness Whereof, I have hereunto set my hand this 7th day of March, 1939.

H. J. Harwick.

In Presence of: ——— ———, ——— ———.

[fols. 25-26] STATE OF MINNESOTA,
County of Olmsted, ss:

On this 7th day of March, 1939, before me personally appeared H. J. Harwick to me known to be the person described in and who executed the foregoing instrument, and acknowledged that he executed the same as his free act and deed.

G. W. Shuster, Notary Public, Olmsted County, Minn. My Commission expires May 3, 1945. (Notarial Seal.)

EXHIBIT B to STIPULATION

Computation proved

INDIVIDUAL INCOME TAX RETURN

FOR NET INCOMES FROM SALARIES OR WAGES OF MORE THAN $5,000 AND INCOMES FROM BUSINESS, PROFESSION, RENTS, OR SALE OF PROPERTY

For Calendar Year 1931

File This Return With the Collector of Internal Revenue for Your District on or Before March 15, 1932

FIELD

Do Not Write In This Space

File No. 315

Serial Number M.i. 658964

District Minnesota

MAR 1932

ST. PAUL OFFICE

Cash Check M.O. Cert. of Int. Paid Payment

$

PRINT NAME AND ADDRESS PLAINLY BELOW

[redacted]

c/o Mayo Clinic

[redacted] Rochester Minn.

(Post office) (County) (State)

Occupation Business Executive

1. Are you a citizen or resident of the United States? Yes
2. If your filed a return for 1930, to what Collector's office was it sent? St. Paul, Minn.
3. Is this a joint return of husband and wife? Yes
4. If husband or wife filed a separate return, state when and where filed. -------
5. Were you married and living with husband or wife on the last day of your taxable year? M
6. If not, were you on the last day of your taxable year supporting in your household one or more persons closely related to you? ---
7. If your status in respect to questions 5 and 6 changed during the year, state date and nature of change. ----
8. How many dependent persons (other than husband or wife) under 18 years of age or incapable of self-support were receiving their chief support from you on the last day of your taxable year? Two

INCOME

1. Salaries, Wages, Commissions, etc. (State name and address of employer)	Amount received	Balance paid (Include on line 1)	
Mayo Clinic, Rochester, Minn.	$ 40,000.00	$	40 000 00
Kahler Corporation, Rochester, Minn.	10,076.25		10 076 25
Director's Fees			35 00
2. Income from Partnerships. (Name of Partnership)			
3. Interest on Bank Deposits, Notes, Corporation Bonds, etc. (except interest on tax-free covenant bonds)			50 00
4. Interest on Tax-free Covenant Bonds Upon Which a Tax was Paid at Source			
5. Income RECEIVED (State name and address) Mayo Clinic, Rochester, Minn.			4 161 68
OCT 6 1932			
ST. PAUL, MINNESOTA			
6. Rents and Royalties. (Form Schedule B)			
7. Profit from Sale of Real Estate, Bonds, etc. (Form Schedule C)			
8. Taxable Interest on Liberty Bonds, etc. (Form Schedule E)			
9. Dividends on Stock of Domestic Corporations			11 861 61
10. Other Income (including dividends on stock of foreign corporations). (State nature of income)			
(a) Warner Oil Syndicate			119 86
(b)			
11. Total Income or Items 1 to 11			16 378 32
DEDUCTIONS			
12. Interest Paid			3 812 25
13. Taxes Paid. (Explain in Schedule F) Real Estate, Pers.Prop. & Inc			1 396 07
14. Losses by Fire, Storm, etc. (Explain in Table at foot of page 4)			
15. Bad Debts. (Explain in Schedule F)			
16. Contributions. (Explain in Schedule F) 15% Limitation			2 125 07
17. Other Deductions Authorized by Law. (Explain in Schedule F)			
18. Total Deductions or Items 12 to 17			7 336 29
19. Net Income (Item 11 minus Item 18)			12 042 03

EARNED INCOME CREDIT

20. Earned Income (not over $30,000)	30000	00
21. Less Personal Exemption and Credit for Dependents	4300	00
22. Balance (Item 21 minus 20)	25700	00
23. Amount taxable at 1½% (not over $4,000)	4000	00
24. Amount taxable at 2% (not over $4,000)	4000	00
25. Amount taxable at 3% (Balance over $8,000 of Item 22)	17700	00
26. Normal Tax (1½% of Item 23)	60	00
27. Normal Tax (2% of Item 24)	120	00
28. Normal Tax (3% of Item 25)	885	00
29. Surtax on Item 21	880	00
30. Tax on Earned Net Income (total of Items 27 to 29)	1945	00
31. Credit of 20% of Tax (not over 20% of Items 26, 27, 28, and 29)	486	25

COMPUTATION OF TAX (See Instruction 22)

32. Net Income (Item 20 above)			12042 03
33. Liberty Bond Interest (Item 9)			
34. Dividends (Item 10)	11861	61	
35. Credit for Dependents	800	00	
36. Personal Exemption	3500	00	
37. Total of Items 33 to 36			16161 61
38. Balance (Item 32 minus 37)			NONE
39. Amount taxable at 1½% (not over $4,000)			
40. Balance (Item 32 minus 39)			
41. Amount taxable at 2% (not over $4,000)			
42. Amount taxable at 3% (Item 41 minus 42)			
43. Normal Tax (1½% of Item 39)			
44. Normal Tax (2% of Item 41)			
45. Normal Tax (3% of Item 42)			
46. Surtax on Item 32 (see Instruction 23)		20	42
47. Tax on Net Income (total of Items 43 to 46)			
48. Tax on Capital Gain or Loss (12½% of Col. 8, Sched. D)			
49. Total of or difference between Items 47 and 48		20	42
50. Less Credit of 20% of Tax on Earned Income (Item 29)		440	00
51. Total Tax (Item 50 minus 49)		NONE	
52. Less Income Tax Paid at Source			
54. Income Tax paid to a foreign country or U. S. possession			
55. Balance of Tax (Item 52 minus Items 53 and 54)		NONE	

AFFIDAVIT

I swear (or affirm) that this return, including the accompanying schedules and statements, has been examined by me, and to the best of my knowledge and belief, is a true and complete return made in good faith for the taxable year stated, pursuant to the Revenue Act of 1928 and the Regulations issued thereunder.

See Instruction 27

Sworn to and subscribed before me this 14 day of Feb 1932.

G C [illegible] TZ, Notary Public,
Rochester, Olmsted County, Minnesota.
My Com. [illegible] expires July 11, 1937

[redacted]

[redacted]

An amended return must be marked "Amended" at top of return. Checks and drafts will be accepted only if payable at par.

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27-28

SCHEDULE A—INCOME FROM BUSINESS OR PROFESSION (See Instruction 2)

1. Total receipts from business or profession (state kind of business) _____

Cost or Quoted Sales		Gross Receipts	
2. Labor			
3. Material and supplies			
4. Merchandise bought for sale			
5. Other costs (Itemize below or on separate sheet)			
6. Plus inventory at beginning of year			
7. Total (Lines 2 to 6)			
8. Less inventory at end of year			
9. Net Cost or Quoted Sales (Line 7 minus Line 8)			

Enter "C," or "C or M," on Lines 8 and 9 to indicate whether inventories are valued at cost, or cost or market, whichever is lower.

Explanation of deductions claimed on Lines 5 and 16 _____

Gross Receipts		Deductions	
10. Interest not included as "net income" and not deduct compensation		"Labor," in Line 2. (Do not deduct compensation for your services)	
11. Interest on business indebtedness		Indebtedness to others	
12. Taxes on business and business property		Business property	
13. Losses (explain in table at foot of page)			
14. Bad debts arising from sales or services			
15. Depreciation, obsolescence, and depletion (explain in table at foot of page)			
16. Rent, repairs, and other business expenses (Itemized below or on separate sheet)			
17. Total (Lines 10 to 16)			
18. Total Deductions (Line 9 plus Line 17)			
19. Net Profit (Line 1 minus Line 18) (Enter on Page 2)			

SCHEDULE B—INCOME FROM RENTS AND ROYALTIES (See Instruction 7)

1. Kind of Property	2. Amount Received	3. Cost or Value as of March 1, 1913, if Received Otherwise	4. Depreciation (Explain in table at foot of page)	5. Rentals	6. Gross Expenses (Itemize below)	7. Net Income (Enter on Line 3)

Explanation of deductions allowed in Column 6 _____

SCHEDULE C—PROFIT FROM SALE OF REAL ESTATE, STOCKS, BONDS, ETC. (See Instruction 8)

1. Kind of Property	2. Date Acquired	3. Amount Received	4. Depreciation Allowable Since Acquisition	5. Cost or Value as of March 1, 1913, if Received Otherwise	6. Improvements	7. Net Profit (Enter on Page 2)
Fairbanks Pfd Stk. 1800 Shs.	7-9-31	27875 00		40650 00		

Make how property was acquired _____

SCHEDULE D—CAPITAL NET GAIN OR LOSS FROM SALE OF ASSETS HELD MORE THAN TWO YEARS (See Instruction 9)

1. Kind of Property	2. Date Acquired	3. Date Sold	4. Amount Received	5. Depreciation Allowable Since Acquisition	6. Cost or Value as of March 1, 1913, if Received Otherwise	7. Improvements (Explain in table at foot of page)	8. Net Profit (Enter on Page 2)
	Mo. Day Year	Mo. Day Year					
Fed. City Bank-100 Shs	7-22-29	12-15-31	3646 72		3810 00		

Make how property was acquired _____

SCHEDULE E—INTEREST ON LIBERTY BONDS AND OTHER OBLIGATIONS OR SECURITIES (See Instruction 9)

1. Obligations or Securities	2. Interest Received or Accrued	3. Amount Owned	4. Interest Exempt from Taxation	5. Amount Owned at Beginning of Taxable Year	6. Amount Owned at Close of Taxable Year	7. Interest Received or Accrued During Taxable Year
(a) Obligations of a State, Territory, or political subdivision thereof, or the District of Columbia						
(b) Securities issued under Federal Farm Loan Act, or under such Act as amended, Treasury Bills, and Treasury Certificates of Indebtedness						
(c) Liberty 3½% Bonds and other obligations of United States issued on or before September 1, 1917, and obligations of U. S. possessions			All	******	******	******
(d) Liberty 4% and 4½% Bonds, Treasury Bonds, and Treasury Savings Certificates			All	******	******	******
			All	******	******	******
(e) Treasury Notes			66,000			
			None			

SCHEDULE F—EXPLANATION OF DEDUCTIONS CLAIMED IN ITEMS 1, 14, 16, 17, AND 18

17-Thru Mayo Clinic $3867.57 Y.M.C.A. $200.00 Church $200.00 Boy Scouts $200.00

Total--$3977.57

EXPLANATION OF DEDUCTION FOR DEPRECIATION CLAIMED IN SCHEDULES A AND B

1. Kind of Property (If building, state material of which constructed)	2. Date Acquired	3. Age When Acquired	4. Probable Life After Acquisition	5. Cost or Value as of March 1, 1913, if Received Otherwise (Exclusive of Land)	Amount of Depreciation Claimed and Allowed	
					6. Previous years	7. This year

EXPLANATION OF DEDUCTION FOR LOSSES BY FIRE, STORM, ETC., CLAIMED IN SCHEDULE A, AND IN ITEM 15

1. Kind of Property	2. Date Acquired	3. Cost or Value as of March 1, 1913, if Received Otherwise	4. Improvements	5. Depreciation Allowable Since Acquisition	6. Insurance and Salvage Value	7. Deductible Loss

EXHIBIT 6 to STIPULATION

FORM 1040
Treasury Department
Internal Revenue Service

UNITED STATES INDIVIDUAL INCOME TAX RETURN 1939

FOR NET INCOMES OF MORE THAN $5,000 FROM SALARIES, WAGES, DIVIDENDS, INTEREST, ANNUITIES, AND FOR INCOMES FROM OTHER SOURCES REGARDLESS OF AMOUNTS

For Calendar Year 1939

or fiscal year beginning 1-1-, 1939, and ended 1-1-, 1940

To be filed with the Collector of Internal Revenue for your district not later than the 15th day of the third month following the close of your taxable year

(Auditor's Stamp)

(Collector's Stamp)

File No. 200675

Serial [illegible]

District Minnesota

PRINT NAME AND ADDRESS PLAINLY. (See Instruction A)

H. J. Harwick - Attention: G. C. Utz
(Name) (If joint return, give first name of husband and wife)

Mayo Clinic
(Street and number, or rural route)

Rochester Olmsted Minnesota
(Post office) (County) (State)

Rec'd Int. Rev. Coll. St. P. MAR 12 1940

Field Check M.O.

Amount 9643.71

INCOME

1. Salaries and other compensation for personal services. (From Schedule A)	$ 89,469	00		
2. Dividends	14,899	50		
3. Interest on bank deposits, notes, mortgages, etc.	8	00		
4. Interest on corporation bonds				
5. Taxable interest on Government obligations, etc. (From Schedule B)				
6. Income (or loss) from partnerships, syndicates, pools, etc. (other than capital gains or losses). (Furnish names and addresses): Warner Syndicate	74	98		
7. Income from fiduciaries. (Furnish names and addresses):				
8. Rents and royalties. (From Schedule C)				
9. Income (or loss) from business or profession. (From Schedule D)				
10. (a) Net short-term gain from sale or exchange of capital assets. (From Schedule F)				
(b) Net long-term gain (or loss) from sale or exchange of capital assets. (From Schedule F)				
(c) Net gain (or loss) from sale or exchange of property other than capital assets. (From Schedule C) Recovery on National City Bank Stock Loss	9,884	22		
11. Other income (including income from annuities) (State nature)				
Total income in items 1 to 11. (Enter corresponding income in Schedule D)			$ 111,352	36

RECD INT. REV. COLL. OF MINN. DIST. MAR 13 1940 ST. PAUL OFFICE

DEDUCTIONS

13. Contributions paid. (Explain in Schedule H)	$ 2,014	16		
14. Interest. (Explain in Schedule H)	120	00		
15. Taxes. (Explain in Schedule H)	7,194	04		
16. Losses from fire, storm, shipwreck, or other casualty, or theft. (Explain in Schedule H)				
17. Bad debts. (Explain in Schedule H)				
18. Other deductions authorized by law. (Explain in Schedule H)				
19. Total deductions in items 13 to 18			9,328	20
20. Net income (item 12 minus item 19)			$ 102,024	36

COMPUTATION OF TAX

21. Net income (item 20 above)			$ 102,024	36	28. Normal tax (4% of item 27)		$ 3,923	64
22. Less: Personal exemption. (From Schedule J-1)	$ 2500	00			29. Surtax on item 24. (See Instruction 29)		29,720	07
23. Credit for dependents. (From Schedule J-2)	33	33	2,533	33	30. Total (item 28 plus item 29)		$ 33,643	71
24. Balance (surtax net income)			$ 99,491	02	31. Total tax (item 30, or if you had a net long-term capital gain or loss, enter line 14, Schedule F)		$	
25. Less: Interest on Government obligations, etc. (See Instruction 25)	$				32. Less: Income tax paid at source	$		
26. Earned income credit. (From Schedule K-1 or K-2)	1400	00	1,400	00	33. Income tax paid to a foreign country or U.S. possession (Attach Form 1116)			
27. Balance subject to normal tax			$ 98,091	02	34. Balance of tax (item 31 minus items 32 and 33)		$	

NOTE.—One form marked "DUPLICATE COPY" must be filed with this original return ($5 will be assessed if duplicate copy is not filed)

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Schedule A—[illegible] LIST OF SALARIES, WAGES, FEES, AND OTHER [illegible] (See Instruction 7)

1. Name and address of employer or nature of business	2. Amount	3. Nature (Insert)	4. Amount
Mayo Clinic, Rochester	76,270 86	Traveling Expense	$ 641 00
[illegible] Corporation, Rochester	$20,000 00		
Wabash, Ind.	108 00		
First Nat'l Bank Minneapolis	160 00		
Total of column 2 minus total of column 4 (enter as item 1, page 1)			$ 86,489 86

Schedule B.—INTEREST ON GOVERNMENT OBLIGATIONS, ETC. (See Instruction C)

1. Obligations or securities	2. Amount owned at end of year (including your proportionate share of such obligations held by estates, trusts, partnerships, or common trust funds)	3. Interest received or credited during the year	4. Interest exempt from taxation	5. Interest on amount in column 2 if taxable
(a) Obligations of a State, Territory, or political subdivision thereof, or the District of Columbia, or United States possessions	$	$	All	
(b) Obligations issued under Federal Farm Loan Act, or under such Act as amended			All	
(c) Obligations of United States issued on or before September 1, 1917			All	
(d) Treasury Notes, Treasury Bills, and Treasury Certificates of Indebtedness			All	
(e) United States Savings Bonds and Treasury Bonds			$	$
(f) Obligations of instrumentalities of the United States (other than obligations to be reported in (b) above)			None	
(g) Total (enter as item 5, page 1)				$

Schedule C.—INCOME FROM RENTS AND ROYALTIES. (See Instruction 8)

1. Kind of property	2. Amount	3. Depreciation (explain in Schedule E)	4. Repairs (explain below)	5. Other expenses (itemize below)	6. Net profit (subtract 3, 4, and 5 from 2) (enter as item 8, page 1)
	$	$	$	$	$

Explanation of deductions claimed in columns 4 and 5 .....

Schedule D.—PROFIT (OR LOSS) FROM BUSINESS OR PROFESSION. (See Instruction 9)

(State business name and address if different from name and address on page 1 .....)

1. Total receipts (state nature of business or profession) ..... $

COST OF GOODS SOLD		OTHER BUSINESS DEDUCTIONS	
2. Labor	$	10. Salaries not included as "Labor" (do not deduct compensation for yourself)	$
3. Material and supplies		11. Interest on business indebtedness	
4. Merchandise bought for sale		12. Taxes on business and business property	
5. Other costs (itemize below)		13. Losses (explain below)	
6. Plus inventory at beginning of year		14. Bad debts arising from sales or services	
7. Total (lines 2 to 6)	$	15. Depreciation, obsolescence, and depletion (explain in Schedule E)	
8. Less inventory at end of year		16. Rent, repairs, and other expenses (itemize below or on separate sheet)	
9. Net cost of goods sold (line 7 minus line 8)	$	17. Total (lines 10 to 16)	$
		18. Total deductions (line 9 plus line 17)	
		19. Net profit (or loss) (line 1 minus line 18) (enter as item 9, page 1)	$

If the production, manufacture, purchase and sale of merchandise is an income-producing factor, inventories are required. Enter "L," or "C or M," on lines 6 and 8 to indicate whether inventories are valued at cost, or cost or market, whichever is lower.

Explanation of deductions claimed in lines 5, 13, and 16 .....

Schedule E.—EXPLANATION OF DEDUCTION FOR DEPRECIATION CLAIMED IN SCHEDULES C, D, F, AND G

1. Kind of property (If buildings, state material of which constructed)	2. Date acquired	3. Cost or other basis	4. Amount fully depreciated as of end of year	5. Depreciation allowed (or allowable) in prior years	6. Remaining cost or other basis to be recovered	7. Estimated life used in accumulating depreciation	8. Estimated remaining life from beginning of year	9. Depreciation allowable this year
		$	$	$	$			$

10 over

Schedule F.—GAINS AND LOSSES FROM SALES OR EXCHANGES OF CAPITAL ASSETS. (See Instructions 10)

1. Kind of property (If necessary, attach separate sheet and identify each item listed)	2. Date acquired (Mo. Day Year)	3. Date sold (Mo. Day Year)	4. Gross sales price (contract price)	5. Cost or other basis	6. Expenses of sale and cost of improvements subsequent to expenditures or March 1, 1913	7. Depreciation allowed (or allowable) since acquisition or March 1, 1913 (explain in Schedule E)	8. Gain or loss (subtract item 6 plus column 4 of Schedule E from item 5 and 7)	Gain or loss to be taken into account: 9. Percentage	10. Amount
SHORT-TERM CAPITAL GAINS AND LOSSES—ASSETS HELD NOT MORE THAN 18 MONTHS									
			$	$	$	$	$	100	$
								100	
								100	
								100	
Total net short-term capital gain or loss (enter in line 1, column 3, of summary below)									$
LONG-TERM CAPITAL GAINS AND LOSSES—ASSETS HELD FOR MORE THAN 18 MONTHS BUT NOT FOR MORE THAN 24 MONTHS									
			$	$	$	$	$	66⅔	$
								66⅔	
								66⅔	
								66⅔	
LONG-TERM CAPITAL GAINS AND LOSSES—ASSETS HELD FOR MORE THAN 24 MONTHS									
			$	$	$	$	$	50	
								50	
								50	
								50	
Total net long-term capital gain or loss (enter in line 2, column 3, of summary below)									$

SUMMARY OF CAPITAL NET GAINS OR LOSSES

1. Classification	2. Net short-term capital loss of preceding taxable year (not in excess of net income for such year)	3. Net gain or loss to be taken into account from column 10, above		4. Net gain or loss to be taken into account from partnerships and "common trust funds"		5. Total net gain or loss to be taken into account for columns 2, 3, and 4 of this summary	
		Gain	Loss	Gain	Loss	Gain	Loss
1. Total net short-term capital gain or loss (enter as item 10 (a), page 1, amount of gain shown in column 5)	$	$	$	$	$	$	No net loss allowable (see Instruction 10)
2. Total net long-term capital gain or loss (enter as item 10 (b), page 1, amount of gain or loss shown in column 5)		$	$	$	$	$	$

State the family, fiduciary, or business relationship to you, if any, of purchaser of any of the above items: _____

If any of the above items were acquired by you other than by purchase, explain fully how acquired: _____

COMPUTATION OF ALTERNATIVE TAX
(To be used only in the case of a net long-term capital gain or loss)

1. Net income (item 28, page 1). (See Instruction 10)	$	10. Normal tax (4% of line 9)	$
2. (a) Net long-term capital gain (item 10 (b), page 1)		11. Surtax on line 6. (See Instruction 29)	
(b) Net long-term capital loss (item 10 (b), page 1)		12. Partial tax (line 10 plus line 11)	$
3. Ordinary net income (line 1 minus line 2 (a) or line 1 plus line 2 (b)). (See Instruction 10)		13. (a) 30% of net long-term capital gain (30% of line 2 (a))	
4. Less: Personal exemption. (From Schedule J-1)	$	(b) 30% of net long-term capital loss (30% of line 2 (b))	
5. Credit for dependents. (From Schedule J-2)		14. Alternative tax (line 12 plus line 13 (a) or line 12 minus line 13 (b))	$
6. Balance (surtax net income)	$	15. Total normal tax and surtax (item 30, page 1)	$
7. Less: Interest on Government obligations, etc. (See Instruction 25)	$	16. Tax liability (if a net long-term capital gain, on line 2 (a), enter line 14 or line 15, whichever is the lesser; if a net long-term capital loss, on line 2 (b), enter line 14 or line 15, whichever is the greater). (Enter as item 31, page 1)	$
8. Earned income credit. (From Schedule K-1 or K-2). (See Inst. 10)			
9. Balance subject to normal tax	$		

Schedule G.—GAINS AND LOSSES FROM SALES OR EXCHANGES OF PROPERTY OTHER THAN CAPITAL ASSETS
(See Instruction 10)

1. Kind of property	2. Date acquired	3. Gross sales price (contract price)	4. Cost or other basis	5. Expenses of sale and cost of improvements subsequent to expenditures or March 1, 1913	6. Depreciation allowed (or allowable) since acquisition or March 1, 1913 (explain in Schedule E)	7. Gain or loss (subtract item 5 plus column 4 minus the sum of columns 4 and 5)
		$	$	$	$	$
Total net gain (or loss) (enter as item 10 (c), page 1)						$

State the family, fiduciary, or business relationship to you, if any, of purchaser of any of the above items: _____

If any of the above items were acquired by you other than by purchase, explain fully how acquired: _____

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Schedule H.—EXPLANATION OF DEDUCTIONS CLAIMED IN ITEMS 20, 21, AND 24

Item No.	1. Deduction	2. Amount		Item No.	3. Recipient (Name)	4. Amount	
15	Real Estate Tax	$ 1,894	10	13	Episcopal Church	$ 454	16
15	Personal Property Tax	210	37	13	Boy Scouts	700	00
15	Excise Tax	85	00	13	Red Cross	10	00
15	Auto Tax	54	37	13	University of Minnesota	500	00
15	State Income	5,560	20	13	Community Chest	250	00
		7,194	04	13	Minn. Medical Foundation	100	00

Schedule I.—NONTAXABLE INCOME OTHER THAN INTEREST REPORTED IN SCHEDULE B. (See Instruction G) $2,014.16

1. Source of Income	2. Nature of Income	3. Amount
		$

Schedule J.—EXPLANATION OF CREDITS CLAIMED IN ITEMS 22 AND 23. (See Instructions 22 and 23)

(1) Personal Exemption

Status	Number of months during the year in each status	Credit claimed
Single, or married and not living with husband or wife		$
Married and living with husband or wife	12	2,500 00
Head of family (explain below)		

(2) Credit for Dependents

Name of dependent and relationship	Number of months during the year: Under 18 years old	Number of months during the year: Over 18 years old	Credit claimed
Mary Anne, Daughter	1		$ 33 33

Reason for support if over 18 years old

Schedule K.—COMPUTATION OF EARNED INCOME CREDIT. (See Instruction 26)

(1) If your net income is $3,000 or less, use only this part of schedule

Net income (item 20, page 1)	$
Earned income credit (10% of net income, above)	

(2) If your net income is more than $3,000, use only this part of schedule

Earned net income (not more than $14,000)	$
Net income (item 20, page 1)	
Earned income credit (10% of earned net income or 10% of net income, above, whichever amount is smaller, but do not enter less than $300)	

QUESTIONS

1. State your principal occupation or profession Business Manager
2. Check whether you are a citizen ☒ or a resident alien ☐.
3. If you filed a return for the preceding year, to which Collector's office was it sent? St. Paul
4. Are items of income or deductions of both husband and wife included in this return? No
5. State (a) Name of husband or wife if separate return was made
   (b) Personal exemption, if any, claimed thereon
   (c) Collector's office to which it was sent
6. Check whether this return was prepared on the cash ☒ or accrual ☐ basis.
7. Did you at any time during your taxable year own directly or indirectly any stock of a foreign corporation or a personal holding company as defined by section 501? (Answer "yes" or "no") No (If answer is "yes," attach statement required by Instruction J.)

AFFIDAVIT. (See Instruction E)

I/we swear (or affirm) that this return (including any accompanying schedules and statements) has been examined by me/us, and to the best of my/our knowledge and belief is a true, correct, and complete return, made in good faith, for the taxable year stated, pursuant to the Internal Revenue Code, as amended, and the regulations issued under authority thereof.

Subscribed and sworn to by H. J. Hanrick before me this 7 day of Feb 1940

G. O. [illegible], Notary Public
Rochester, Minn.
My Commission Expires

(Signature) (See Instruction E)

(Signature)

(If this is a joint return (not made by agent), it must be signed by both husband and wife. It must be sworn to before a proper officer by the spouse preparing the return. If neither or both prepare the return, it must be sworn to by both spouses.)

If made abroad by an agent must be accompanied by power of attorney. (See Instruction E.)

AFFIDAVIT. (See Instruction E)

(If this return was prepared for you by some other person, the following affidavit must be executed)

I/we swear (or affirm) that I/we prepared this return for the person or persons named herein and that the return (including any accompanying schedules and statements) is a true, correct, and complete statement of all the information respecting the income tax liability of the person or persons for whom this return has been prepared of which I/we have any knowledge.

Subscribed and sworn to before me this ..... day of ....., 194

(Signature and title of officer administering oath)

(Signature of person preparing the return)

(Signature of person preparing the return)

(Name of firm or employer, if any)

U. S. GOVERNMENT PRINTING OFFICE 16—6054

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[fol. 39] BEFORE UNITED STATES BOARD OF TAX APPEALS

PRAECIPE FOR TRANSCRIPT—Filed August 6, 1942

To the Clerk of the United States Board of Tax Appeals:

You are requested by the petitioner in the above entitled action to prepare, transmit, and deliver to the Clerk of the United States Circuit Court of Appeals for the Eighth Circuit copies, duly certified as correct, of the following documents and records in the above entitled cause in connection with the Petition for Review heretofore filed by said petitioner:

1. Docket entries of proceedings before the Board.

2. Pleadings before the Board.

3. Opinion of the Board promulgated March 30, 1942.

4. Decision filed April 23, 1942.

5. Petition for Review, together with notice of filing thereof and proof of service.

6. The stipulation of facts agreed upon between the parties.

7. This Praecipe.

Dated August 6, 1942.

Leland W. Scott, John W. Windhorst. Agreed to:
J. P. Wenchel, Attorney for Respondent.

UNITED STATES BOARD OF TAX APPEALS, WASHINGTON

Docket No. 105790

H. J. HARWICK, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

CLERK'S CERTIFICATE TO TRANSCRIPT

[fol. 40] I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to

34, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 19th day of August, 1942.

B. D. Gamble, Clerk, United States Board of Tax Appeals. Filed Aug. 29, 1942, E. S. Kock, Clerk. (Seal: U. S. Board of Tax Appeals, 1924.)

IN THE UNITED STATES CIRCUIT COURT OF APPEALS, FOR THE EIGHTH CIRCUIT

ORDER CONSOLIDATING CASES FOR BRIEFING, HEARING, ARGUMENT AND DECISION AND AS TO PRINTING OF RECORDS—September 10, 1942

[Title omitted]

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* * * * * * *

[fol. 41] Come Now the parties to the above entitled proceedings, by their counsel of record, and it is

Ordered, that the above entitled proceedings be consolidated for briefing, hearing, argument and decision; that one brief shall be filed on behalf of the Commissioner and one on behalf of the four taxpayers; that the first brief shall be filed by the Commissioner and that it shall be filed within forty days after the date on which the last transcript of record is filed with the Clerk of this Court in the cases in which the Commissioner has filed petitions for review; that the second brief shall be filed on behalf of the taxpayers twenty-five days after their receipt of the Commissioner's brief, in accordance with the rules of this Court; that in order to facilitate handling of these proceedings and also to provide a fair and practicable method of dividing costs, the transcripts of record in the three cases appealed by the Commissioner shall be consolidated for printing and be printed by the Commissioner when his brief is printed; that such record shall include, in the case of John

V. Dobson, all the material needed to consider both of the issues referred to above with the exception of the cross-petition for review which shall be printed as hereinafter indicated; that the transcript of record in H. J. Harwick v. Commissioner and the cross-petition in the case of John V. Dobson shall be printed together by the taxpayers therein with the cost of printing to be divided between them as [fol. 42] they shall decide; and that the latter record shall be printed by the taxpayers in sufficient time for it to be available for use by counsel for Commissioner in preparation of his brief, or they shall furnish a copy of the record to be printed to counsel for Commissioner in ample time for his use.

September 10, 1942.

[fol. 42-A] UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT

B. T. A. Docket No. 106553

JOHN V. DOBSON, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

PETITION OF JOHN V. DOBSON FOR REVIEW OF DECISION OF UNITED STATES BOARD OF TAX APPEALS—Filed July 20, 1942, United States Board of Tax Appeals

To the Honorable Judges of the United States Circuit Court of Appeals for the Eighth Circuit:

Now comes John V. Dobson, by his attorneys, Leland W. Scott and John W. Windhorst, and respectfully shows:

I

JURISDICTION

The petitioner on review is an individual residing in the City of Minneapolis, County of Hennepin, State of Minnesota. The respondent on review holds his office under and by virtue of the laws of the United States. An income tax return was filed by the Petitioner for the calendar year 1939 on or about March 15, 1940, with the Collector of Internal

Revenue for the District of Minnesota in St. Paul, Minnesota, whose office is located within the judicial district of the United States Circuit Court of Appeals for the Eighth Circuit.

II

Nature of Controversy

On December 26, 1940, the Commissioner forwarded to the Petitioner by registered mail a notice of deficiency [fol. 42-B] wherein the Petitioner was notified of a deficiency in the amount of $9,108.06 in his income tax liability for the year 1939.

Thereafter, on March 3, 1941, the Petitioner filed with the Board of Tax Appeals a petition for redetermination of the proposed deficiency for the year 1939. On March 31, 1941, the Commissioner filed with the Board of Tax Appeals his answer to the petition of the Petitioner. The proceeding came on to be heard before a division of the Board of Tax Appeals sitting in St. Paul, Minnesota, on June 18, 1941.

The questions presented are (1) whether the Petitioner must include in his taxable gross income for the calendar year 1939 the amount of $2,251.49 representing a portion of the amount received in settlement of a suit for rescission of a purchase of National City Bank of New York stock by the Petitioner from National City Company, and (2) if said amount is to be included in Petitioner's taxable income for 1939, whether it is to be treated as ordinary income or as capital gain under Section 117 of the Internal Revenue Code.

On March 27, 1942, the Board of Tax Appeals promulgated its opinion wherein it was held that the Petitioner was taxable on the amount of $2,251.49 of the total received in settlement of damage suits in 1939 and excluded by the Petitioner from the taxable income reported in his return for 1939. The Board further held that said $2,251.49 was taxable as ordinary income rather than capital gain. On April 22, 1942, the board entered its decision and order that there was a deficiency of $472.82 in the Petitioner's income tax liability for the calendar year 1939. On or about April 28, 1942, the Petitioner paid the entire amount of said deficiency, plus interest in the amount of $60.27, to the Collector of Internal Revenue for the District of Minnesota.

The facts shortly stated are as follows: At various times in 1929 the petitioner purchased from National City Com-

pany a total of 440 shares of capital stock in the National City Bank of New York. During 1930 the Petitioner sold a portion of this stock for $20,897.44. This stock had cost the Petitioner $83,168.44 and Petitioner thereby sustained a loss on said stock in the sum of $62,271, which amount was allowed by the Commissioner as a deduction in deter- [fol. 42-C] mining the Petitioner's income tax liability for 1930. In 1938 Petitioner commenced a suit against the National City Company wherein he sought to rescind the purchase of the stock for alleged fraud on the part of the defendant and violations of the Minnesota Blue Sky Law. The action was settled during the year 1939 by a net payment of $33,404 by the National City Company to the Petitioner. Of the amount received in settlement, $32,294.96 is allocable to the stock sold by the Petitioner in 1930. This latter amount was not included in the taxable income reported by Petitioner in his 1939 income tax return. If the deductible loss suffered during 1930 upon the sale of National City Bank stock were reduced by the amount of 1939 recovery allocable to the shares sold during 1930, the 1930 income tax return of the Petitioner would have shown a net income of $2,251.49. Because of a personal exemption in the amount of $3500 and a credit for dependents in the amount of $1200, the tax liability of the Petitioner for 1930 under these circumstances would have been zero. The loss on the stock sales in 1930, to the extent compensated for by the 1939 settlement, resulted in no tax saving to the Petitioner.

III

Points Upon Which Petitioner Intends to Rely

Petitioner is aggrieved at the decision of the Board of Tax Appeals and says that in the proceeding before the Board and in the opinion and decision aforesaid manifest error occurred and intervened to his prejudice and he assigns as error the following:

1. The Board of Tax Appeals erred in determining that there is a deficiency of $472.82 in Petitioner's income tax liability for 1939, in that its decision is contrary to law.

2. The Board of Tax Appeals erred in finding that a part of the amount received in settlement of the legal action against the National City Company in 1939, to the extent

of $2,251.49, was [includable] in the Petitioner's taxable income for the calendar year 1939 under Section 22 of the Internal Revenue Code.

3. The Board of Tax Appeals erred in finding that a part [fol. 42-D] of the amount received in settlement of the legal action against the National City Company in 1939 in the amount of $2,251.49 was to be treated as ordinary income rather than capital gain under Section 117 of the Internal Revenue Code.

4. The Board of Tax Appeals erred in failing to find that none of the amount recovered in settlement of the legal action against the National City Company in 1939 and allocable to the purchase price of stock of National City Bank of New York which was sold in 1930 was [includable] in the taxable income of the Petitioner in 1939, under Sec. 22 of the Internal Revenue Code.

5. The Board of Tax Appeals erred in entering judgment that there was a deficiency of $472.82 in the amount of Petitioner's income tax liability for the calendar year 1939, instead of entering judgment of no deficiency for said year, in that the uncontradicted evidence warrants no other conclusion.

Wherefore, The Petitioner requests that the aforesaid decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Eighth Circuit; that a transcript of record be prepared in accordance with law and the rules of this Court and transmitted to the Clerk of said Court for filing; and that appropriate action be taken to the end that errors complained of may be reviewed and corrected by the Court.

Leland W. Scott, John W. Windhorst, Counsel for Petitioner, 1300 First National-Soo Line Building, Minneapolis, Minnesota.

* * * * * * *

Duly sworn to by John W. Windhorst, Jurat omitted in printing.

[fol. 42-E] In United States Circuit Court of Appeals, for the Eighth Circuit

B. T. A. Docket No. 106553

John V. Dobson, Petitioner on Review

vs.

Commissioner of Internal Revenue, Respondent on Review

To: J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue.

Notice of Filing of Petition for Review by John V. Dobson and Acknowledgment of Service

(Received and Filed July 22, 1942, United States Board of Tax Appeals)

You are hereby notified that John V. Dobson did, on the 20th day of July, 1942, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Eighth Circuit, of the decision of the Board heretofore rendered in the above entitled case. Copies of the petition for review and the statement of points as filed are hereto attached and served upon you.

Dated this 21st day of July 1942.

B. D. Gamble, Clerk U. S. Board of Tax Appeals.

[fol. 42-F] Service of copy of Petition for Review and Statement of Points acknowledged this July 22, 1942.

J. P. Wenchel, Attorney for Respondent.

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UNITED STATES BOARD OF TAX APPEALS, WASHINGTON

Docket No. 106553

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

v.

JOHN V. DOBSON, Respondent

Docket No. 106553

JOHN V. DOBSON, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

CLERK'S CERTIFICATE TO TRANSCRIPT

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 76, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 25th day of August, 1942.

B. D. Gamble, Clerk, United States Board of Tax Appeals.

Filed Sept. 2, 1942. E. E. Koch, Clerk.

(Seal) Board of Tax Appeals, 1924.

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* * * * * * *

[fol. 42-G] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

[Title omitted]

ORDER CONSOLIDATING CASES FOR BRIEFING, HEARING, ARGUMENT AND DECISION AND AS TO PRINTING OF RECORDS—September 10, 1942

Come Now the parties to the above entitled proceedings, by their counsel of record, and it is

Ordered, that the above entitled proceedings be consolidated for briefing, hearing, argument and decision; that

one brief shall be filed on behalf of the Commissioner and one on behalf of the four taxpayers; that the first brief shall [fol. 42-H] be filed by the Commissioner and that it shall be filed within forty days after the date on which the last transcript of record is filed with the Clerk of this Court in the cases in which the Commissioner has filed petitions for review; that the second brief shall be filed on behalf of the taxpayers twenty-five days after their receipt of the Commissioner's brief, in accordance with the rules of this Court; that in order to facilitate handling of these proceedings and also to provide a fair and practicable method of dividing costs, the transcripts of record in the three cases appealed by the Commissioner shall be consolidated for printing and be printed by the Commissioner when his brief is printed; that such record shall include, in the case of John V. Dobson, all the material needed to consider both of the issues referred to above with the exception of the cross-petition for review which shall be printed as hereinafter indicated; that the transcript of record in H. J. Harwick v. Commissioner and the cross-petition in the case of John V. Dobson shall be printed together by the taxpayers therein with the cost of printing to be divided between them as they shall decide; and that the latter record shall be printed by the taxpayers in sufficient time for it to be available for use by counsel for Commissioner in preparation of his brief, or they shall furnish a copy of the record to be printed to counsel for Commissioner in ample time for his use.

September 10, 1942.

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[fols. 1-3] UNITED STATES BOARD OF TAX APPEALS

Docket No. 106566

COMMISSIONER OF INTERNAL REVENUE, Petitioner

v.

ESTATE OF JAMES N. COLLINS, DECEASED, FIRST NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, EXECUTOR, Respondent

ORDER ENLARGING TIME

Upon motion of counsel for petitioner, it is ordered that the time for preparation, transmission and delivery of the

record sur petition for review of the above-entitled proceeding in the United States Circuit Court of Appeals for the Eighth Circuit is extended to October 12, 1942.

(Signed) J. E. Murdock, Member.

Dated: Washington, D. C., August 13, 1942.
eeh.

Now, September 2, 1942 the foregoing order is certified from the record as a true copy.

B. D. Gamble, Clerk, U. S. Board of Tax Appeals.

[Endorsed:] Filed in U. S. Circuit Court of Appeals on September 4, 1942.

Before United States Board of Tax Appeals

Docket No. 106566

James N. Collins (Amended Title—Estate of James N. Collins, Deceased, First National Bank and Trust Company of Minneapolis), Executor, Petitioner

v.

Commissioner of Internal Revenue, Respondent

Appearances: For Taxpayer: Leland W. Scott, John W. Windhorst. For Comm'r: Jonas Smith, Esq., S. U. Hiken, Esq.

[fol. 4] Docket Entries

1941
Mar. 3—Petition received and filed. Taxpayer notified. Fee paid.
Mar. 3—Copy of petition served on General Counsel.
Mar. 3—Request for Circuit hearing in St. Paul, Minnesota, filed by taxpayer. 3/3/41 copy served.
Mar. 31—Answer filed by General Counsel.
Apr. 3—Copy of answer served on taxpeyer. (St. Paul, Minnesota.)
Apr. 28—Hearing set June 16, 1941, St. Paul, Minnesota.
June 9—Motion for substitution of petitioner filed by taxpayer.

June 9—Order that henceforth the caption of this proceeding shall be Estate of James N. Collins, Deceased, First National Bank and Trust Company of Minneapolis, Executor, entered.

June 18—Hearing had before Mr. Turner on motion of respondent to file amended answer. Granted. Amended answer. Copy served.

June 18—Hearing had before Mr. Turner on the merits submitted. Stipulation as to the facts filed. Briefs due Aug. 2, 1941. Reply briefs Aug. 18, 1941.

July 25—Brief filed by taxpayer.

July 28—Motion for extension to Aug. 15, 1941, to file brief filed by General Counsel. 7/31/41 granted.

Aug. 2—Transcript of hearing 6/18/41 filed.

Aug. 11—Motion for extension of time to Aug. 30, 1941, to file briefs filed by General Counsel. 8/14/41 granted.

Aug. 29—Brief filed by General Counsel.

Sept. 2—Copy of brief served on General Counsel.

Sept. 13—Reply brief filed by taxpayer. 9/15/41 copy served.

1942

Mar. 27—Opinion rendered. Turner, Div. 8. Decision will be entered under Rule 50. 3/30/42 copy served.

Apr. 22—Agreed computation of deficiency filed.

Apr. 25—Decision entered. Arthur Mellott, Div. 11.

July 14—Petition for review by U. S. Circuit Court of Appeals, 8th Circuit, with assignments of error filed by General Counsel.

July 21—Proof of service filed by General Counsel.

Aug. 13—Motion for extension of time to 10/12/42 within which to prepare, transmit, and deliver the record filed by General Counsel.

[fol. 5] Aug. 13—Order enlarging time to Oct. 12, 1942, to prepare, transmit, and deliver the record entered.

Aug. 21—Praecipe for record filed by General Counsel, with proof of service thereon.

United States Board of Tax Appeals

Docket No. 106566

JAMES N. COLLINS, Petitioner

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Received Mar. 3, 1941. U. S. Board of Tax Appeals.

PETITION

The above-named Petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his Notice of Deficiency dated February 18, 1941, and as a basis for the proceeding alleges:

I.

The Petitioner, James N. Collins, is an individual residing in the City of Minneapolis, County of Hennepin, State of Minnesota. On or about March 15, 1940, Petitioner filed an income tax return for the calendar year 1939 with the Collector of Internal Revenue of the United States in and for the District of Minnesota.

II

The Notice of Deficiency, a copy of which, marked Exhibit A, is attached hereto and hereby made a part hereof, was mailed to Petitioner on February 18, 1941. The taxes in controversy are income taxes for the calendar year 1939 asserted against the Petitioner by said notice.

III

The Notice of Deficiency determined that Petitioner's income tax liability for the calendar year 1939 was $2,331.04. No part of this has been paid by the Petitioner and Respondent determined a deficiency in Petitioner's income tax liability for the calendar year 1939 in said sum of $2,331.04. The entire amount of said deficiency is in controversy.

[fol. 6]

IV

The determination of tax set forth in said Notice of Deficiency is based on the following errors:

(a) Respondent erred in determining that $29,750.63, out of the net amount of $45,150.63 recovered by Petitioner during the calendar year 1939 from National City Company, constituted income taxable to the Petitioner.

(b) Respondent erred in determining that the entire amount of said $45,150.63 recovered by Petitioner from National City Company did not constitute a return of capital to the Petitioner.

(c) Respondent erred in determining that Petitioner realized any income as the result of the recovery by Petitioner of said $45,150.63 from said National City Company.

(d) If the Petitioner realized income as the result of said recovery from National City Company, Respondent erred in determining that said income did not constitute capital gain under the provisions of Section 117 of the Internal Revenue Code.

(e) Respondent erred in determining that there is a deficiency in Petitioner's income tax liability for the calendar year 1939.

V

The facts upon which Petitioner relies as a basis for this proceeding are as follows:

(a) On or about the dates and for the amounts set forth below the Petitioner purchased and sold stock of National City Bank of New York:

1. On January 2, 1929, Petitioner purchased 5 shares at a cost of $1,325.

2. On April 8, 1929, Petitioner purchased 85 shares at a cost of $31,875.

3. On May 27, 1929, Petitioner purchased 10 shares at a cost of $3,900.

4. On October 14, 1929, Petitioner purchased 100 shares at a cost of $56,200.

5. On November 11, 1929, Petitioner purchased 100 shares at a cost of $30,000.

6. On August 29, 1930, Petitioner sold the 100 shares purchased at item 4 above for $14,599.20.

7. On April 22, 1931, Petitioner sold the 5 shares of stock purchased at item 1 above for the sum of $446.81.

[fol. 7] 8. On April 22, 1931, Petitioner sold the 10 shares of stock purchased at item 3 above for $893.62.

9. On April 22, 1931, Petitioner sold the 85 shares purchased at item 2 above for $7,595.79.

(b) On or about March 15, 1931, the Petitioner filed with the Collector of Internal Revenue of the United States in and for the District of Minnesota an income tax return for the calendar year 1930. The net income disclosed by said return, exclusive of losses realized by the sale of capital assets, was $19,830.13. During the calendar year 1930 the Petitioner sold securities other than stock of National City Bank of New York and realized a loss on said sale in the net amount of $44,125.84. On or about August 29, 1930, Petitioner sold 100 shares of the stock of National City Bank of New York, as set forth at item V (a) 6 above. Petitioner thereby realized a loss of $41,600.80. Said loss was reported by Petitioner in his income tax return for said calendar year 1930. The income and deductions set forth in Petitioner's income tax return for the calendar year 1930 are a true and correct statement of Petitioner's net income for said year and Respondent has not made any changes therein.

(c) On or about March 15, 1932, Petitioner filed an income tax return for the calendar year 1931 with the Collector of Internal Revenue of the United States in and for the District of Minnesota. In said return Petitioner disclosed the following gross income and deductions therefrom:

Income:		
Salaries	$21,639.12	
Interest	10,586.89	
Rents and royalties	275.09	
Dividends on stock of domestic corporations	11,117.47	
Miscellaneous income and directors' fees	756.51	
Total income		$44,375.08

Deductions:		
Interest paid	$2,346.69	
Taxes paid	1,492.56	
Contributions	1,112.30	
Loss on sale of stocks and bonds other than stock of National City Bank of New York	51,454.65	
Loss on sale of stock of National City Bank of New York	28,163.78	
Total Deductions		84,579.98
Net income		None

The income and deductions set forth above are a true and correct statement of Petitioner's net income for the calendar year 1930 and the Respondent has not made any changes [fol. 8] therein. The loss sustained on the sale of stock of National City Bank of New York in the sum of $28,163.78, described in said return, was realized from the sale of 100 shares of said stock for the sum of $8,936.22, as set forth at items V (a) 7, 8, and 9 above. Said stock was acquired by Petitioner at a cost of $37,100, as set forth at items V (a) 1, 2, and 3 above.

(d) During the calendar year 1939 the Petitioner instituted suit against the National City Company for the recovery of the purchase price of the stock of National City Bank of New York purchased from National City Company on April 8, 1929, May 27, 1929, October 14, 1929, and November 11, 1929, as set forth in paragraph V (a) 2, 3, 4, and 5 above. Said suit was dismissed and Petitioner received, during the calendar year 1939, as consideration for said dismissal, the net amount of $45,150.63. The sum of $6,454.18 was recovered with respect to the 85 shares of stock purchased on April 8, 1929 (item V (a) 2 above), and 10 shares of stock purchased on May 27, 1929 (item V (a) 3 above); $23,296.45 was recovered with respect to the 100 shares of stock purchased on October 14, 1929 (item V (a) 4 above); and $15,400 was recovered with respect to the 100 shares of stock purchased on November 11, 1929, (item V (a) 5 above).

(e) Except for said recovery of $45,150.63 during the calendar year 1930, Petitioner has not been reimbursed in any manner for the loss sustained on the sale of stock of

National City Bank of New York as set forth in paragraph V (a) above.

Wherefore, petitioner prays that this Board may hear the proceeding and decide that:

(a) Respondent erred in determining that $29,750.63, out of the net amount of $45,150.63 recovered by Petitioner during the calendar year 1939 from National City Company, constituted income taxable to the Petitioner.

(b) Respondent erred in determining that the entire amount of said $45,150.63 recovered by Petitioner from National City Company did not constitute a return of capital to the Petitioner.

(c) Respondent erred in determining that Petitioner realized any income as the result of the recovery by Petitioner of said $45,150.63 from said National City Company.

(d) If the Petitioner realized income as the result of said recovery from National City Company, Respondent erred in determining that said income did not constitute capital gain under the provisions of Section 117 of the Internal Revenue Code.

[fol. 9] (e) Respondent erred in determining that there is a deficiency in Petitioner's income tax liability for the calendar year 1939.

Leland W. Scott, Leland W. Scott, John W. Windhorst, John W. Windhorst, 1300 First National-Soo Line Bldg., Minneapolis, Minnesota, Attorneys for Petitioner.

Duly sworn to by James N. Collins. Jurat omitted in printing.

EXHIBIT "A" TO PETITION

SN-IT-1

Office of Internal Revenue Agent in Charge, St. Paul Division, 800 Post Office Bldg.

Treasury Department, Internal Revenue Service, St. Paul, Minnesota, Feb. 18, 1941.

Collection District: Minnesota

Mr. James N. Collins,
c/o Roy F. Hooker,
924 Baker Building, Minneapolis, Minnesota.

SIR: You are advised that the determination of your income tax liability for the taxable year (x) 1939 discloses a deficiency of $2,331.04 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date [fol. 10] of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, St. Paul, Minnesota for the attention of LGE-90D. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,
Guy T. Helvering, Commissioner. By C. W. Rink,
Internal Revenue Agent in Charge.

Enclosures: Statement. Form of waiver. LGE/mrr.

STATEMENT

Mr. James N. Collins, c/o Roy F. Hooker, 924 Baker Building, Minneapolis, Minnesota

Tax Liability for Taxable Year Ended January 3, 1941

Income tax: Liability, $2,331.04; assessed, None; deficiency, $2,331.04.

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated January 3, 1941.

Investigation disclosed that there is allowable a credit for one dependent only, namely, your sister, Mrs. W. C. Winslow.

Adjustments to Net Income

Net income (loss) as disclosed by return	($6,833.41)
Unallowable deductions and additional income:	
(a) Recovery	29,750.63
Net income adjusted	22,917.22

Explanation of Adjustments

(a) In 1939 you recovered $45,150.63 as a result of a suit against the National City Company, due to illegal sales of [fol. 11] stock by that company. No portion of this recovery was included as taxable income in your return. It is held that the net recovery in connection with that stock previously sold constitutes taxable income in its entirety, and that the recovery on stock retained during 1939 constitutes a reduction in the cost basis of same.

	Total stock	Stock retained	Stock previously disposed of
Recovery, 84% of loss	$67,725.95	$23,100.00	$44,625.95
Attorney fees	22,575.32	7,700.00	14,875.32
Net recovery	45,150.63	15,400.00	29,750.63

Computation of Tax

Adjusted net income		$22,917.22
Less:		
Personal exemption	$1,000.00	
Credit for dependents	400.00	1,400.00
Surtax net income		21,517.22
Less: Earned income credit		300.00
Balance subject to normal tax		21,217.22
Normal tax at 4%		848.69
Surtax		1,487.58
Total tax		2,336.27
Less: Income tax paid at source		5.23
Total tax assessable		2,331.04
Tax previously assessed: Account No. 656162		None
Deficiency of income tax		2,331.04

UNITED STATES BOARD OF TAX APPEALS

Docket No. 106566

JAMES N. COLLINS, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Received Mar. 31, 1941. U. S. Board of Tax Appeals

ANSWER

Now comes the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed herein, admits, denies and alleges:

[fol. 12] I, II, and III. Admits the allegations contained in paragraphs I, II, and III of petition.

IV. (a) to (e), inclusive. Denies that the respondent erred as alleged in subparagraphs (a) to (e), inclusive, of paragraph IV of the petition.

V. (a) Admits that sometime prior to 1939 the petitioner purchased and sold stock of National City Bank; denies the remaining allegations contained in subparagraph (a) of paragraph V of the petition.

V. (b) Admits that sometime prior to 1939 the petitioner sold stock of National City Bank; admits that petitioner realized a loss on said sale, the exact amount of which is unknown to the respondent; denies the remaining allegations contained in subparagraph (b) of paragraph V of the petition.

V. (c) Denies the allegations contained in subparagraph (c) of paragraph V of the petition.

V. (d) Admits that during the calendar year 1939 the petitioner instituted a suit against the National City Company; admits that petitioner received the net amount of $45,150.63 in 1939 on account of the institution of said suit; denies the remaining allegations contained in subparagraph (d) of paragraph V of the petition.

V. (e) Denies the allegations contained in subparagraph (e) of paragaph V of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore specifically admitted, qualified or denied.

Wherefore, respondent prays that the Board redetermine the deficiency herein to be the amount determined by the Commissioner, viz.: $2,331.04 in respect of income taxes for the taxable year 1939.

(Signed) J. P. Wenchel, S. U. H., J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue.

Of counsel: F. R. Shearer, Division Counsel. S. U. Hiken, Special Attorney, Bureau of Internal Revenue.

[fol. 13] UNITED STATES BOARD OF TAX APPEALS

Docket No. 106566

JAMES N. COLLINS, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

AMENDED ANSWER—*Filed at hearing June* 16, 1941

Now comes the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for amended answer to the petition filed herein admits, denies and alleges:

I, II, and III. Admits the allegations contained in paragraphs I, II, and III of petition.

IV. (a) to (e), inclusive. Denies that the respondent erred as alleged in subparagraphs (a) to (e), inclusive, of paragraph IV of the petition.

V. (a) Admits that sometime prior to 1939 the petitioner purchased and sold stock of National City Bank; denies the remaining allegations contained in subparagraph (a) of paragraph V of the petition.

V. (b) Admits that sometime prior to 1939 the petitioner sold stock of National City Bank; admits that petitioner realized a loss on said sale, the exact amount of which is unknown to the respondent; denies the remaining allega-

tions contained in subparagraph (b) of paragraph V of the petition.

V. (c) Denies the allegations contained in subparagraph (c) of paragraph V of the petition.

V. (d) Admits that during the calendar year 1939 the petitioner instituted a suit against the National City Company; admits that petitioner received the net amount of $45,150.63 in 1939 on account of the institution of said suit; denies the remaining allegations contained in subparagraph (d) of paragraph V of the petition.

V. (e) Denies the allegations contained in subparagraph (e) of paragraph V of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore specifically admitted, qualified or denied.

VI. Further answering, and by way of affirmative allegation, respondent alleges that he erred in determining the amount of deficiency in income tax due from the petitioner [fol. 14] herein for the year 1939 in that he should have disallowed the following deductions which were claimed in the petitioner's return but not disallowed in the deficiency notice:

Item	Amount
Office expenses, including bookkeeping, postage, etc.	$221.46
Agent's Salary	500.00
Attorneys' Fees	210.00
1st National Bank & Trust Co. Advisory Service	573.68
Safety Deposit Box rent	9.00
Total	1,514.14

VII. The facts upon which the respondent relies in support of said allegation of error are as follows:

(a) On information and belief, it is alleged that the aforementioned items were claimed as deductions by the petitioner as business expenses on the theory that the petitioner was engaged in a trade or business in 1939.

(b) On information and belief, it is alleged that the petitioner was not engaged in a trade or business during the year

1939 and that the aforesaid items were not paid or incurred in the operation of a business by the petitioner and hence do not constitute expenditures which are deductible from gross income.

(c) On information and belief, it is alleged that the petitioner's activities throughout 1939, on account of which the foregoing expenditures were made, consisted only of the performance of such acts as were necessary to look after and manage petitioner's personal investments.

Wherefore, it is prayed that petitioner's appeal be denied and that the deficiency for the year 1939 be redetermined by adding to the adjusted net income appearing in the statement attached to the deficiency notice from which the appeal herein was taken the amount of $1,514.14 as set forth in paragraph VI and subparagraphs (a) to (c), inclusive, of paragraph VII of this answer. Claim is hereby asserted for the increased deficiency for the year 1939 resulting from such redetermination.

(Signed) J. P. Wenchel, D. A. T., J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue.

Of Counsel: F. R. Shearer, Division Counsel; S. U. Hiken, Special Attorney, Bureau of Internal Revenue.

[fol. 15] UNITED STATES BOARD OF TAX APPEALS

ESTATE OF JAMES N. COLLINS, DECEASED, FIRST NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, EXECUTOR, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 106566. Promulgated March 27, 1942

In 1929 the decedent purchased in the State of Minnesota certain bank stock from the National City Co. of New York. In 1930 and 1931 he sold the stock for less than its purchase price and in his returns for those years claimed deductions for the losses so sustained. The returns for the said years would have disclosed net losses even if the deductions in respect of the above stock sales had not been claimed. In 1936 decedent learned that the bank stock had not been registered in accordance with the Minnesota Blue Sky Laws

and in 1937 filed suit against the company for rescission of the contract. The suit was settled by compromise and in 1939 the company paid a sum of money to the decedent as full settlement. The purchase price of the stock paid by decedent exceeds the proceeds of the 1930 and 1931 sales plus the amount recovered in 1939. *Held,* the money recovered in 1939 does not constitute taxable income to the decedent.

John W. Windhorst, Esq., for the petitioner.
S. U. Hiken, Esq., for the respondent.

OPINION

Turner: The respondent determined a deficiency in income tax for 1939 in the amount of $2,331.04. The issue is whether a sum of money recovered by the decedent in the taxable year as a result of litigation involving certain stock transactions in prior years constitutes a return of capital, as contended by petitioner, or taxable income, as contended by the respondent. The parties have filed a written stipulation of facts, with certain exhibits attached thereto, and the Board adopts such stipulation as its findings of fact. We shall recite only the facts deemed necessary to the discussion of the issue presented.

The decedent, James N. Collins, died on April 21, 1941, a resident of Hennepin County, State of Minnesota. He filed his income tax return for 1939 with the collector of internal revenue at St. Paul, Minnesota. The petitioner is the duly appointed executor of his estate.

[fol. 16] In 1929 the decedent purchased 300 shares of the capital stock of the National City Bank of New York. The stock also carried certain beneficial interests in the stock of the National City Co. of New York. The purchase was made in the State of Minnesota from the National City Co. In 1930 the decedent sold 100 shares of the stock, which had cost him $56,200, for $14,599.20, thereby sustaining a deductible loss for Federal income tax purposes in the amount of $41,600.80. This loss was claimed as a deduction in his 1930 return and was allowed by the respondent. In 1931 the decedent sold 100 shares of the stock, which had cost him $37,100, for $8,936.22, thereby sustaining a deductible loss for income tax purposes in the amount of $28,163.78. This loss was claimed as a deduction in his 1931 return and was allowed by the respondent. The remaining 100 shares

of stock referred to were still owned by the decedent at the time of his death.

Until the fall of 1936 the decedent regarded the aforesaid purchases and sales as closed and completed transactions. During that fall he learned for the first time that the stock had not been registered in accordance with the requirements of the Minnesota Blue Sky Laws and further learned of facts which led him to believe that the sales by the company to him might have been fraudulent. On August 23, 1937, he filed suit against the National City Co. in an effort to recover the amounts which he paid for the stock, alleging that the stock had been sold to him without having been registered in accordance with the requirements of the Minnesota Blue Sky Laws and that the sales had been fraudulent. He asked for a rescission of the entire transaction and tendered to the defendant company the proceeds of said stock, or an equivalent number of shares of stock of the bank, plus interest and dividends received.

In 1939 the suit was settled by a payment of $67,725.95 by the company to the decedent, such amount representing 84 percent of the losses he had sustained in his dealings with the stock. After deducting attorney's fees and other expenses in connection with the suit, the decedent had a net recovery of $45,150.63. On March 28, 1939, the suit was dismissed, with prejudice, pursuant to stipuation of the parties. Of the total net recovery, $29,750.63 is allocable to the stock sold by the decedent in 1930 and 1931, of which $23,296.45 is allocable to the stock sold in 1930 and the balance of $6,454.18 is allocable to the stock sold in 1931.

If the entire deductions of $41,600.80 for 1930 and $28,163.78 for 1931, claimed and allowed on the decedent's returns for those years, had been disallowed, the returns [fol. 17] still would have shown net losses for those years. If the decedent had received $23,296.45 on the sale of the stock in 1930 in addition to the amount actually received on such sale, and if he had received $6,454.18 on the said of the stock in 1931 in addition to the amount actually received on such sale, his 1930 and 1931 net losses would have been $42,600.06 and $33,750.72, respectively, and he would have had no income tax liability for either year.

Throughout the taxable year 1939 adjustment of the decedent's income tax liability for 1930 and 1931 was barred by the statute of limitations.

In his income tax return for 1939 the decedent did not report as income any portion of the recovery received from the National City Co. In the deficiency notice the respondent adjusted the amount of gross income reported by adding thereto and treating as ordinary gain the amount of $29,750.63 representing that portion of the net recovery which was attributable to the shares of stock sold by the decedent in 1930 and 1931. He did not add that portion of the recovery which was attributable to the 100 shares of stock which had not been disposed of by the decedent.

Petitioner contends that the suit brought by the decedent against the National City Co. was in the nature of an action for rescission of the original contract and that the amount recovered in 1939 is in the nature of a capital recovery which does not constitute taxable income in the absence of realization of gain, either actually or constructively, and that he realized no gain, since the deductions claimed in the years when the stock was sold did not result in any "tax benefits" to him. In the alternative, petitioner contends that, if the amount recovered is taxable to the decedent, it is taxable as capital gain. The respondent contends that the entire amount recovered by the decedent from the company is taxable as ordinary gain and that it is wholly immaterial whether he realized any "tax benefits" from the deductions taken in the prior years.

We think the record supports the petitioner's contention that the suit brought by the decedent was in the nature of an action for rescission of the original contract, as distinguished from an action for damages. In the complaint he prayed for a rescission of the entire transaction and the return of the purchase price of the stock, and he tendered the proceeds of the stock, or an equivalent number of shares of stock, plus interest and dividends received. Had the suit been disposed of in the regular procedure and resulted in a court order placing the parties in status quo, it would seem that the purchase price thus recovered by petitioner [fol. 18] would represent a return of capital, rather than taxable income. But the suit was not disposed of in that manner. It was settled by a stipulated compromise, the company paying an amount of money to the decedent. True, the decedent had already sold the stock in 1930 and 1931, but that fact does not require the conclusion that the transactions were completely closed at that time because the decedent still maintained his right of action against the

company. Moreover, regarding the series of transactions as a whole, it is apparent that no gain was actually realized by the decedent. The purchase price which he paid for the stock is in excess of the proceeds realized from the sales in 1930 and 1931 plus the total net recovery in 1939. Therefore, it seems to us that the real question presented is whether the fact that the decedent sold the stock in 1930 and 1931 and claimed deduction in his returns for those years, for which he realized no tax benefits, requires us to hold that the amount recovered in 1939 constitutes taxable income, even though he realized no economic gain.

In Burnet v. Canford & Brooks Co., 282 U. S. 359, which case is strongly relied upon by the respondent, the taxpayer entered into a contract with the United States Government for dredging the Delaware River. In its income tax returns from 1913 to 1916 it added to gross income for each year the payments received under the contract and deducted its expenses paid in performing the contract. The total expenses exceeded the payments received and its returns for 1913, 1915, and 1916 showed net losses. Its return for 1914 showed net income. In 1915 work under the contract was abandoned and in 1916 the taxpayer brought suit to recover for a breach of warranty of the character of the material to be dredged. It obtained judgment in the Court of Claims, the court stating that the recovery was upon the contract and was "compensatory of the cost of the work, of which the government got the benefit." The recovery was received in 1920 and the Supreme Court held that it constituted gross income for that year despite the fact that in the prior years the taxpayer had suffered net losses in the conduct of its business which were in some measure attributable to expenditures made to produce the net income of the latter period. In so holding the Court pointed out that there was no statutory authority for disregarding the annual accounting periods to permit the bringing forward of losses sustained in the prior years to offset the taxable income received in a later year. The Court found, however, that the money received in the later year was in the nature of an income item, as distinguished [fol. 19] from a non-income item such as a return of capital. On that point the Court said:

That the recovery by respondent in 1920 was gross income for that year within the meaning of these sections

cannot, we think, be doubted. The money received was derived from a contract entered into in the course of respondent's business operations for profit. While it equalled, and in a loose sense was a return of, expenditures made in performing the contract, still as the Board of Tax Appeals found, the expenditures were made in defraying the expenses incurred in the prosecution of the work under the contract for the purpose of earning profits. They were not capital investments, the cost of which, if converted, must first be restored from the proceeds before there is a capital gain taxable as income. See Doyle v. Mitchell Brothers Co., supra, page 185 of 247 U. S. 38 S. Ct. 467.

In cases involving bad debts, which are similar to the instant case in that the original disbursement represents an outlay of capital, we have held that, where a bad debt deduction does not effect an offset of taxable income for the years deducted, then a recovery of the debt in a subsequent year should not be included in gross income in the year of recovery. State-Planters Bank & Trust Co., 45 B. T. A. 630, and National Bank of Commerce of Seattle, 40 B. T. A. 72; affd., 115 Fed. (2d) 875. In the last case we also said that, where the amount previously deducted effects an offset of taxable income, the subsequent recovery should be included in taxable income. The reason behind the ruling is that by the prior deduction of the amount of the loss from taxable income the taxpayer has already had, for income tax purposes, a recoupment of the capital out of taxable income. Any further recovery is accordingly in the nature of a replacement of taxable income and, being in excess of the reduced cost of the capital asset, is equivalent to gain to the taxpayer. Affirming National Bank of Commerce of Seattle, the court stated the principle as follows:

* * * when * * * * a loan becomes worthless, the amount thereof is loss of capital, but the income tax laws permit the bank to recoup its capital by deducting from the profits or income the amount of the loss. Thus the bank does not pay a tax on all its income, but on the amount of income less the loss on the worthless debt. The debt itself then loses its nature as capital, but represents that portion of the income which was not taxed, and the capital is the money taken from the profits or income. If the loan, after being deducted from income, is paid, then the lender is receiving profit or income—otherwise the lender would

doubt its capital on one transaction. In other words the profits or income used to pay back the capital when the debt is charged off is represented by the worthless loan, so that when such loan is paid the profits are replaced.

Applying the rationale of that case to the facts in the instant case, we conclude that, since the deductions taken by the decedent in 1930 and 1931 did not effect an offset of taxable income, the recovery in 1939 must be treated as a return of capital rather than taxable income. This conclusion is in accord with the principle expressed in Central Loan & Investment Co., 39 B. T. A. 981, and Amsco-Wire [fol. 20] Products Corporation, 44 B. T. A. 717. The respondent's argument seems to be that those cases have been erroneously decided, but he cites no authority to the contrary. In fact, as pointed out in Central Loan & Investment Co., supra, and National Bank of Commerce of Seattle, supra, the conclusions reached therein are in accord with the views expressed by the General Counsel of the Bureau of Internal Revenue in G. C. M. 18525 (C. B. 1937–1, p. 80) and G. C. M. 20854 (C. B. 1939–1, p. 102). The rulings expressed therein were in effect during the taxable year, but have since been modified or revoked by G. C. M. 22163 (C. B. 1940–2, p. 76). Our conclusion here also seems to be in accord with the recent case of Seldon R. Glenn *v.* Louisville Trust Co.—Fed. (2d)—(C. C. A., 6th Cir., Jan. 6, 1942).

In view of our holding that the net recovery of $29,750.63 received by the decedent in 1939 does not constitute income, it is unnecessary to consider petitioner's alternative contention that if the recovery constitutes income it should be taxed as capital gain.

Petitioner concedes an affirmative issue raised in the respondent's amended answer relating to the deduction of certain business expenses.

Decision will be entered under Rule 50.

UNITED STATES BOARD OF TAX APPEALS, WASHINGTON

Docket No. 106566

ESTATE OF JAMES N. COLLINS, DECEASED, FIRST NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, EXECUTOR, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

DECISION

Pursuant to the Opinion of the Board promulgated March 27, 1942, the parties herein having filed on April 22, 1942, an agreed recomputation of tax in accordance therewith, it is

Ordered and decided: That there is no deficiency in income tax for the year 1939.

Enter:

(Signed) Arthur J. Mellett, Member.

Entered Apr. 25, 1942.

[fol. 21] UNITED STATES BOARD OF TAX APPEALS

Docket No. 106566

ESTATE OF JAMES N. COLLINS, DECEASED, FIRST NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, EXECUTOR, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

U. S. Board of Tax Appeals, filed at hearing June 18, 1941

STIPULATION OF FACTS

It is hereby stipulated and agreed by and between the parties hereto, by their respective counsel, that the following facts shall be taken as true, provided, however, (1) that each of the parties hereto reserves the right to object to the admissibility in evidence of any of such facts on the ground of irrelevancy and immateriality and (2) that this stipulation shall be without prejudice to the right of either party to introduce other and further evidence not inconsistent herewith:

I

James N. Collins, a resident of Hennepin County, Minnesota, filed, within the time required by law, his 1939 Federal income tax return with the Collector of Internal Revenue at St. Paul, Minnesota. Said James N. Collins died on April 21, 1941, and First National Bank and Trust Company of Minneapolis, petitioner herein, is the duly appointed, authorized, and acting Executor under the Will of said James N. Collins.

II

In 1929 decedent purchased at various times in transactions entered into for profit a total of 300 shares of capital stock of National City Bank (hereinafter referred to as the stock), the purchases carrying with them at no additional cost proportionate beneficial interests in the stock of National City Company (of New York). In 1933 the name of the latter company was changed to City Company of New York. These purchases were made by decedent in the State of Minnesota from the National City Company.

III

In 1930 the decedent sold 100 shares of said stock, together with said beneficial interests in the capital stock of National City Company, which had cost him $56,200 for $14,599.20, [fol. 22] thereby sustaining a deductible loss for Federal income tax purposes in the amount of $41,600.80. This loss, which the decedent claimed as a deduction from gross income in his Federal income tax return for 1930, was allowed as a deduction by the Respondent.

IV

In 1931 the decedent sold 100 shares of said stock, together with said beneficial interests in the capital stock of National City Company, which had cost him $37,100 for $8,936.22, thereby sustaining a deductible loss for Federal income tax purposes in the amount of $28,163.78. This loss was claimed by decedent as a deduction from gross income in his Federal income tax return for 1931 and the loss was allowed as a deduction by the Respondent.

V

The remaining 100 shares of the stock referred to in paragraph III, supra, which cost the decedent $30,000, has never

been disposed of but was held and owned by the decedent up until the time of his death and is now held and owned by the Petitioner.

VI

Until the fall of 1936 decedent regarded the aforesaid purchases and sales as closed and completed transactions. During the fall of 1936 decedent learned for the first time that said stock had not been registered in accordance with the requirements of the Minnesota Blue Sky laws and for the first time decedent learned of facts which led him to believe that said sales might have been fraudulent. On August 23, 1937, the decedent filed a suit against National City Company in an effort to recover the amounts which he paid for the stock in 1929. The decedent's contentions in said action were (1) that the stock had been sold to him without having been registered in accordance with the requirements of the Minnesota Blue Sky laws and (2) that the sales had been fraudulent. A copy of the complaint in said action is attached hereto, marked Exhibit A, and made a part hereof the same as if fully set forth herein.

VII

This suit was settled by the payment to the decedent in 1939 of $67,725.95, representing 84% of $80,626.13, which amount represented the loss sustained by decedent on his dealings in National City Bank stock with National City Company. Said loss does not correspond with the figures set forth above because all of the losses sustained by de- [fol. 23] cedent were not involved in said litigation with National City Company. On March 28, 1939, said action was dismissed with prejudice pursuant to stipulation between the parties thereto. A copy of the stipulation for dismissal executed on such settlement is attached hereto, marked Exhibit B, and made a part hereof the same as if fully set forth herein.

VIII

The amount received by the decedent on account of the aforesaid settlement, after deducting attorneys' fees and other expenses in connection with the suit, was $45,150.63. Of said total net recovery $29,750.63 is allocable to the stock sold by the decedent in 1930 and 1931 (see paragraphs III and IV, supra). Of said amount of $29,750.63, $23,296.45

is allocable to the stock sold by decedent in 1930 and the balance, or $6,454.18, is allocable to the stock sold by the decedent in 1931.

IX

In his Federal income tax return for 1939 the decedent reported no income as the result of the receipt of said $29,750.63. In the deficiency notice from which the appeal herein was taken the Respondent adjusted the amount of income reported by the decedent by adding thereto said $29,750.63, thus treating the entire amount of said net recovery as gross income to the Petitioner taxable in full. The Respondent did not add the amount of said net recovery with respect to the 100 shares of stock referred to in paragraph V, supra, which was not disposed of by the decedent and which is still held and owned by the Petitioner. It is conceded that the recovery allocable to the latter stock does not constitute taxable income.

X

If the entire deduction of $41,600.80, which was claimed and allowed on decedent's 1930 Federal income tax return (paragraph III hereof), had been disallowed, no deficiency in decedent's Federal income tax liability for 1930 would have resulted, as shown by the following computation:

Net income per return	($65,896.51)
Add loss claimed on sale of National City Bank stock with respect to which James N. Collins made a recovery in 1939	41,600.80
Net income revised	($24,295.71)
Total tax assessable	None

Throughout 1939 adjustment of decedent's Federal income tax liability for 1930 was barred by the statute of limitations.

[fol. 24]

XI

If decedent had received $23,296.45 on the sale of the stock in 1930 in addition to the amounts received upon the sale of the stock as set forth in paragraph III hereof, his 1930

loss would have been $42,600.06 and his Federal income tax liability for 1930 would have been zero, computed as follows:

Net income as shown in the original return	($65,896.51)
Add: Entire amount recovered in 1939 in reduction of loss on stock sold in 1930	23,296.45
Net income revised	($42,600.06)
Total tax assessable	None

XII

If the entire deduction of $28,163.78, which was claimed and allowed on decedent's 1931 Federal income tax return (paragraph IV hereof), had been disallowed, no deficiency in decedent's Federal income tax liability for 1931 would have resulted, as shown by the following computation:

Net income per return	($40,204.90)
Add loss claimed on sale of National City Bank stock with respect to which James N. Collins made recovery in 1939	28,163.78
Net income devised	($12,041.12)
Total tax assessable	None

Throughout 1939 adjustment of decedent's Federal income tax liability for 1931 was barred by the statute of limitations.

XIII

If decedent had received $6,454.18 on the sale of the stock in 1931 in addition to the amounts received upon the sale of the stock as set forth in paragraph IV hereof, his 1931 loss would have been $33,750.72 and his Federal income tax liability for 1931 would have been zero, computed as follows:

Net income as shown in original return	($40,204.90)
Add entire amount recovered in 1939 in reduction of loss on stock sold in 1931	6,454.18
Net income revised	(33,750.72)
Total tax assessable	None

XIV

Photostats of decedent's Federal income tax returns for the years 1930, 1931, and 1939 are attached hereto, marked Exhibits C, D, and E, respectively, and made a part hereof as if fully set forth herein. The income, deductions, and credits for the years 1930 and 1931 set forth in said returns are true and correct and Respondent has made no change [fol. 25] therein upon audit of said returns.

XV

Petitioner concedes the affirmative issue raised in the Respondent's amended answer.

John W. Windhorst, Counsel for Petitioner.

(Signed) J. P. Wenchel, D. A. T., Chief Counsel, Bureau of Internal Revenue, Counsel for Respondent.

United States Circuit Court of Appeals for the Eighth Circuit

B. T. A. Docket No. 106566

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, Petitioner on Review

vs.

ESTATE OF JAMES N. COLLINS, DECEASED, FIRST NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, EXECUTOR, Respondent on Review

Received July 14, 1942. U. S. Board of Tax Appeals.

PETITION FOR REVIEW

To the Honorable Judges of the United States Circuit Court of Appeals for the Eighth Circuit:

Guy T. Helvering, Commissioner of Internal Revenue, holding office by virtue of the laws of the United States, hereby petitions for review by the United States Circuit Court of Appeals for the Eighth Circuit of the decision entered by the United States Board of Tax Appeals on April 25, 1942, ordering and deciding that there is no deficiency in income tax for the year 1939 due from the taxpayer, First National Bank and Trust Company of Minneapolis, Executor, Estate of James N. Collins, Deceased, the

respondent on review: The income tax return for the year 1939 was filed with the Collector of Internal Revenue for the District of Minnesota, located at St. Paul, Minnesota.

[fol. 26] The question presented is whether the decedent received income in the amount of $29,750.63 which is an allocable portion of the sum of $67,725.95 received by him in 1939 in compromise of a suit filed against the National City Company of New York for rescission of a contract entered into in 1929 for the purchase of bank stock. The decedent sold part of the stock in 1930 and 1931 at losses which he claimed as deductions in his income tax returns for these years. Until the fall of 1936 the decedent regarded the purchase and sales of the stock as closed and completed transactions, but upon learning that the stock had not been registered under the Massachusetts Blue Sky Laws, subsequently instituted the suit which led to the recovery in 1939. The decedent did not report as taxable income any part of the amount recovered by him and the Commissioner included in taxable income the sum of $29,750.63, the part allocable to the stock sold in 1930 and 1931, as taxable income in the deficiency notice issued by him.

The Board of Tax Appeals reversed the Commissioner's determination and held that no part of the sum $29,750.63, allocable to the stock sold by the decedent in 1930 and 1931, is includible in taxable income for 1939 for the reason that the decedent did not derive a tax benefit from the deductions for the losses taken in 1930 and 1931.

The Commissioner avers that in the record and proceedings before the United States Board of Tax Appeals and in the opinion and decision rendered and entered by the United States Board of Tax Appeals manifest error occurred and intervened to the prejudice of the Commissioner who now assigns the following points on which he intends to rely in this proceeding:

The United States Board of Tax Appeals erred—

(1) In holding and deciding that no part of $29,750.63 recovered by the decedent in 1939 in settlement of a suit for rescission of a contract for the purchase of stock in 1929, part of which stock was sold in 1930 and 1931 and losses therefrom were claimed and allowed as deductions from gross income in determining the income tax liability of the decedent for the years 1930 and 1931, should be included in the decedent's gross income for 1939.

(2) In failing to hold and decide that $29,750.63 of the amount recovered by the decedent in 1939 in settlement of a suit for rescission of a contract for the purchase of bank stock in 1929, part of which stock was sold in 1930 and 1931 and losses therefrom were claimed and allowed as deductions from gross income in determining the income tax liability of the decedent for the years 1930 and 1931, constituted taxable income for 1939.

[fol. 27] (3) In entering its decision wherein it ordered and decided that there is no deficiency in income tax due for the calendar year 1939.

(4) In failing and refusing to enter its decision redetermining that there is a deficiency in income tax in the amount of $2,644.58 for the taxable year 1939.

(5) In that its decision is not supported by the evidence.

(6) In that its decision is contrary to law and regulations.

(Sgd.) Samuel O. Clark, Jr., Assistant Attorney General; (Signed) J. P. Wenchel, R. L. W., Chief Counsel, Bureau of Internal Revenue, Attorneys for Petitioner on Review.

RHT/mer 6/25/42.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

B. T. A. Docket No. 106566

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, Petitioner on Review

vs.

ESTATE OF JAMES N. COLLINS, DECEASED, FIRST NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, EXECUTOR, Respondent on Review

Received July 21, 1942. U. S. Board of Tax Appeals.

NOTICE OF FILING PETITION FOR REVIEW

To First National Bank and Trust Company of Minneapolis, Executor, Estate of James N. Collins, Deceased, Minneapolis, Minnesota.

You are hereby notified that the Commissioner of Internal Revenue did, on the 14th day of July, 1942, file with the

United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Eighth Circuit of the decision of the Board [fol. 28] heretofore rendered in the above-entitled case. A copy of the petition for review as filed is hereto attached and served upon you.

Dated this 14th day of July 1942.

(Signed) J. P. Wenchel, R. L. W., Chief Counsel, Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review mentioned therein is hereby acknowledged this — day of July 1942.

(S.) First National Bank and Trust Co., Minneapolis, Minn. L. A. Lyson, Assistant Secretary, Respondent on Review.

RHT/mer 6/25/42.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

B. T. A. Docket No. 106566

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, Petitioner on Review

vs.

ESTATE OF JAMES N. COLLINS, DECEASED, FIRST NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, EXECUTOR, Respondent on Review

Received Aug. 21, 1942. U. S. Board of Tax Appeals.

PRAECIPE FOR RECORD

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Eighth Circuit, copies duly certified as correct of the following documents and records in the above-entitled cause in connection with the petition for review by the said Circuit Court of Appeals for the Eighth Circuit, heretofore filed by the Commissioner of Internal Revenue:

1. Docket entries of the proceedings before the Board.

[fol. 29] 2. Pleadings before the Board: (a) Petition, including annexed copy of deficiency letter; (b) Answer.

3. Findings of fact, opinion and decision of the Board.

4. Petition for review, together with proof of service of notice of filing petition for review and of service of a copy of petition for review.

5. Orders enlarging time for the preparation of the evidence and for the transmission and delivery of the record not included in record.

6. This praecipe.

(Signed) J. P. Wenchel, R. L. W., Chief Counsel, Bureau of Internal Revenue.

Service of a copy of the within praecipe is hereby admitted this 18th day of August 1942.

(S.) Leland W. Scott, Attorney for Respondent on Review.

(S.) John W. Windhorst, Attorney for Respondent on Review.

UNITED STATES BOARD OF TAX APPEALS, WASHINGTON

Docket No. 106566

COMMISSIONER OF INTERNAL REVENUE, Petitioner

v.

ESTATE OF JAMES N. COLLINS, DECEASED, FIRST NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, EXECUTOR, Respondent

CERTIFICATE

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 71, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 29 day of September 1942.

[Seal.] B. D. Gamble, Clerk, United States Board of Tax Appeals.

[fol. 30] UNITED STATES BOARD OF TAX APPEALS

Docket No. 106567

COMMISSIONER OF INTERNAL REVENUE, Petitioner

v.

E. W. DOBSON, Respondent

ORDER ENLARGING TIME

On motion of counsel for the petitioner, it is ordered that the time for preparation, transmission and delivery of the record *sur* petition for review of the above entitled proceeding in the United States Circuit Court of Appeals, Eighth Circuit, is extended to September 19, 1942.

(Signed) J. E. Murdock, Member.

Dated: Wash. D. C., July 20, 1942.
lj.

Now, Sept. 2, 1942 the foregoing order is certified from the record as a true copy.

B. D. Gamble, Clerk, U. S. Board of Tax Appeals.

[Endorsed:] Filed in U. S. Circuit Court of Appeals on Sept. 4, 1942.

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 106567

E. W. DOBSON, Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Appearances: For Taxpayer: Leland W. Scott, Esq., John W. Windhorst, Esq. For Comm'r.: S. U. Hiken, Esq.

DOCKET ENTRIES

1941

Mar. 3—Petition received and filed. Taxpayer notified. Fee paid.

Mar. 3—Copy of petition served on General Counsel.

Mar. 3—Request for Circuit hearing in St. Paul, Minnesota, filed by taxpayer. 3/3/41 copy served.

Mar. 31—Answer filed by General Counsel.

[fol. 31] Apr. 3—Copy of answer served on taxpayer. (St. Paul, Minnesota.)

Apr. 28—Hearing set June 16, 1941, St. Paul, Minnesota.
June 18—Hearing had before Mr. Turner on the merits submitted. Stipulation as to the facts. Briefs due Aug. 2, 1941. Reply briefs Aug. 18, 1941.
July 25—Brief filed by taxpayer.
July 28—Motion for extension to Aug. 15, 1941, to file brief filed by General Counsel. 7/31/41 granted.
Aug. 2—Transcript of hearing 6/18/41 filed.
Aug. 11—Motion for extension of time to Aug. 30, 1941, to file brief filed by General Counsel. 8/14/41 granted.
Aug. 29—Brief filed by General Counsel.
Sept. 2—Copy of brief served on General Counsel.
Sept. 13—Reply brief filed by taxpayer. 9/15/41 copy served.

1942

Mar. 30—Memorandum opinion rendered. Turner, Decision will be entered for petitioner. 3/30/42 copy served.
Mar. 30—Decision entered. Murdock, Div. 3.
June 22—Petition for review by U. S. Circuit Court of Appeals, 8th Circuit, with assignments of error filed by General Counsel.
June 30—Affidavit of service filed.
July 1—Proof of service of petition for review filed.
July 20—Motion for extension to 9/21/42 to transmit record filed by General Counsel.
July 20—Order enlarging time to Sept. 19, 1942, to prepare and deliver the record entered.
Aug. 21—Praecipe for record filed by General Counsel, with proof of service thereon.

UNITED STATES BOARD OF TAX APPEALS

Docket No. 106567

E. W. DOBSON, Petitioner

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Received Mar. 3, 1941. U. S. Board of Tax Appeals.

PETITION

The above named Petitioner hereby petitions for a redetermination of the deficiency set forth by the Commis-

[fol. 32] sioner of Internal Revenue in his Notice of Deficiency dated January 11, 1941, and as a basis for the proceeding alleges:

I

The Petitioner, E. W. Dodson, is an individual residing in the City of Wayzata, County of Hennepin, State of Minnesota. On or about March 15, 1940, Petitioner filed an income tax return for the calendar year 1939 with the Collector of Internal Revenue of the United States in and for the District of Minnesota.

II

The Notice of Deficiency, a copy of which, marked Exhibit A, is attached hereto and hereby made a part hereof, was mailed to Petitioner on January 11, 1941. The taxes in controversy are income taxes for the calendar year 1939 asserted against the Petitioner by said notice.

III

The Notice of Deficiency determined that Petitioner's income tax liability for the calendar year 1939 was $8,823.75. Of this amount $1,332.89 was paid by the Petitioner during the calendar year 1940 and Respondent determined a deficiency in Petitioner's income tax liability for the calendar year 1939 in the sum of $7,490.86. The entire amount of said deficiency is in controversy.

IV

The determination of tax set forth in said Notice of Deficiency is based on the following errors:

(a) Respondent erred in determining that the entire amount of $32,384.80, recovered by Petitioner during the calendar year 1939 from National City Company, constituted income taxable to the Petitioner.

(b) Respondent erred in determining that $31,432.80 of said $32,384.80, recovered by Petitioner from National City Company did not constitute a return of capital to the Petitioner.

(c) Respondent erred in determining that Petitioner realized income in excess of the sum of $952 as the result of the

recovery by Petitioner of said $32,384.80 from said National City Company.

(d) Respondent erred in determining that the income realized by Petitioner as the result of said recovery from National City Company did not constitute capital gain under the provisions of Section 117 of the Internal Revenue Code.

[fol. 33] (e) Respondent erred in determining that there is a deficiency in Petitioner's income tax liability for the calendar year 1939.

V

The facts upon which Petitioner relies as a basis for this proceeding are as follows:

(a) On or about the dates and for the amounts set forth below the Petitioner purchased and sold stock of National City Bank of New York:

1. On December 11, 1928, Petitioner purchased 40 shares at a cost of $10,120.

2. On April 10, 1929, Petitioner purchased 50 shares at a cost of $18,850.

3. On August 16, 1929, Petitioner purchased 70 shares at a cost of $27,580.

4. On October 10, 1929, Petitioner purchased 40 shares at a cost of $19,800.

5. On October 29, 1929, Petitioner sold the 200 shares purchased at items 1, 2, 3, and 4 above for $74,000.

6. On October 30, 1929, Petitioner purchased 200 shares at a cost of $70,000.

7. On December 3, 1930, Petitioner sold the 200 shares purchased at item 6 above for $20,697.44.

8. On July 3, 1931, Petitioner purchased 200 shares at a cost of $17,700.

9. On July 13, 1931, Petitioner sold the 200 shares purchased at item 8 above for $16,000.

The cost of the purchases described above represents the actual cash outlay of the Petitioner and does not necessarily

determine the income tax cost of said stock to the Petitioner inasmuch as some of the above sales represent wash sales of said stock, thereby increasing the cost of subsequent purchases of said stock as required by the Revenue Act of 1928.

(b) On or about March 15, 1931, the Petitioner filed with the Collector of Internal Revenue of the United States in and for the District of Minnesota an income tax return for the calendar year 1930. Said income tax return disclosed the following gross income and deductions therefrom:

Income:		
Salaries	$10,400.00	
Dividends on stock of domestic corporations	13,130.60	
Total income		$23,530.60
[fol. 34] Deductions:		
Interest paid	$4,425.60	
Loss on sale of stock of National City Bank of New York	49,302.50	
Total deductions		53,728.16
Net income		None

Except as hereinafter set forth with respect to the loss arising from the sale of stock of National City Bank of New York, the income and deductions set forth above are a true and correct statement of Petitioner's net income for the calendar year 1930 and Respondent has not made any changes therein. The loss sustained on the sale of stock of National City Bank of New York in the sum of $49,302.50, described in said return, was realized from the sale of 200 shares of said stock for the sum of $20,697.44 on December 3, 1930, as set forth at item V (a) 7 above. In Petitioner's income tax return for said calendar year 1930 the cost of said stock was set forth as $70,000. The correct income tax cost of said stock was $77,000 and the Petitioner therefore sustained a loss upon the sale of said stock in 1930 in the sum of $57,673.94.

(c) During the calendar year 1939 the Petitioner instituted suit against the National City Company for the re-

covery of the purchase price of stock of National City Bank of New York purchased from said National City Company on April 10, 1929, August 16, 1929, October 10, 1929, and October 30, 1929, as set forth in paragraph V (a) 2, 3, 4, 6, and 8 above. Said suit was dismissed and Petitioner received as consideration for said dismissal the net amount of $32,384.80. The sum of $31,432.80 was recovered with respect to the 50 shares of stock purchased on April 10, 1929 (item V (a) 2 above), the 70 shares of stock purchased on August 16, 1929 (item V (a) 3 above), the 40 shares of stock purchased on October 10, 1929 (item V (a) above), and the 200 shares of stock purchased on October 30, 1929 (item V (a) 6 above); and $952 was recovered with respect to the $200 shares of stock purchased on July 3, 1931 (item V (a) 8 above).

(d) Except for said recovery of $32,384.80 during the calendar year 1939 Petitioner has not been reimbursed in any manner for the loss sustained on the sale of stock of National City Bank of New York as set forth in paragraph V (a) above.

Wherefore, Petitioner prays that this Board may hear the proceeding and decide that:

(a) Respondent erred in determining that the entire amount of $32,384.80, recovered by Petitioner during the calendar year 1939 from National City Company, constituted income taxable to the Petitioner.

[fol. 35] (b) Respondent erred in determining that $31,432.80 of said $32.384.80 recovered by Petitioner from National City Company did not constitute a return of capital to the Petitioner.

(c) Respondent erred in determining that Petitioner realized income in excess of the sum of $952 as the result of the recovery by Petitioner of said $32,384.80 from said National City Company.

(d) Respondent erred in determining that the income realized by Petitioner as the result of said recovery from National City Company did not constitute capital gain under the provisions of Section 117 of the Internal Revenue Code.

(e) Respondent erred in determining that there is a deficiency in Petitioner's income tax liability for the calendar year 1939.

Leland W. Scott, John W. Windhorst, 1300 First National-Soo Line Bldg., Minneapolis, Minnesota, Attorneys for Petitioner.

* * * * * * *

Duly sworn to by E. W. Dobson. Jurat omitted in printing.

[fol. 36] EXHIBIT "A" TO PETITION

Form 1230 SN-IT-1

Office of Internal Revenue Agent in Charge, St. Paul Division, 800 Post Office Building.

Treasury Department, Internal Revenue Service, St. Paul, Minnesota, Jan. 11, 1941.

Collection District: Minnesota

Mr. E. W. Dodson, Wayzata, Minnesota.

SIR:

You are advised that the determination of your income tax liability for the taxable year(x) 1939 discloses a deficiency of $7,490.86 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, St. Paul, Minnesota, for the attention of LGE-90D. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period termi-

nates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully, Guy T. Helvering, Commissioner, by C. W. Rink, Internal Revenue Agent in Charge.

Enclosures: Statement. Form of Waiver.

LGE/Mrr.
GPO 2-17679.

[fol. 37] STATEMENT

Mr. E. W. Dobson, Wayzata, Minnesota

Tax Liability for Taxable Year Ended December 31, 1939

Income tax: Liability $8,823.75; assessed $1,332.89; deficiency, $7,490.86.

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated November 5, 1940.

Adjustments to Net Income

Net income as disclosed by return	$17,010.67
Unallowable deductions and additional income:	
(a) Settlement income	31,432.80
Net income adjusted	$48,443.47

Explanation of Adjustments

(a) During the year 1929 you purchased 360 shares of stock of National City Bank which was sold in 1929 and 1930 at a loss. During 1939, $32,384.80 was received in settlement of a suit brought against the National City Company, based on the contention that the original sale of this stock was illegal, being in violation of the security laws of the State of Minnesota, governing such sales. It is held that the net amount received in settlement is taxable in its entirety.

Net amount received	$32,384.80
Reported	952.00
Adjustment	31,432.80

Computation of Tax

Adjusted net income	$48,443.47
Less: Personal exemption	1,250.00
Balance (surtax net income)	47,193.47
Less: Earned income credit—maximum	1,400.00
Balance subject to normal tax	45,793.47
Normal tax at 4%	1,831.74
Surtax on $47,193.47	6,942.24
Total tax	8,773.98
Total tax (alternative tax in case of a net long-term loss)	8,823.75
Total tax assessable	8,823.75
Tax previously assessed: Acct. No. 201834	1,332.89
Deficiency of income tax	7,490.86

[fol. 38] Computation of Alternative Tax

Net income adjusted	$48,443.47
Net long-term capital loss	3,240.75
Ordinary net income	51,684.22
Less: Personal exemption	1,250.00
Balance (surtax net income)	50,434.22
Less: Earned income credit	1,400.00
	49,034.22
Normal tax at 4% on $49,034.22	1,961.37
Surtax on $50,434.22	7,834.61
Total partial tax	9,795.98
30% of net long-term capital loss	972.23
Total alternative tax	8,823.75

UNITED STATES BOARD OF TAX APPEALS

Docket No. 106567

E. W. DOBSON, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Received Mar. 31, 1941. U. S. Board of Tax Appeals.

ANSWER

Now comes the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed herein admits, denies, and alleges as follows:

I and II. Admits the allegations contained in paragraphs I and II of the petition.

III. Admits that in the notice of deficiency it was determined that petitioner's income tax liability for the calendar year 1939 is $8,823.75; admits that respondent determined a deficiency in petitioner's income tax liability for the calendar year 1939 in the sum of $7,490.86; admits that the entire amount of said deficiency is in controversy; denies the remaining allegations contained in paragraph III of the petition.

IV. (a) to (e), inclusive. Denies that the respondent erred as alleged in subparagraphs (a) to (e), inclusive, of paragraph IV of the petition.

V. (a) Admits that sometime in 1929 the petitioner purchased 360 shares of stock of National City Bank; admits [fol. 39] that petitioner sold said stock at a loss in 1929 and 1930; denies the remaining allegations contained in subparagraph (a) of paragraph V of the petition.

V. (c) *Admits that during the caendar year 1929 the peti-* (b) of paragraph V of the petition, except it is admitted that in 1930 the petitioner sustained a substantial loss, the exact amount of which is unknown to the respondent, on the sale sometime in that year of National City Bank stock purchased by the petitioner in 1929.

V. (c) Admits that during the calendar year 1929 the petitioner instituted a suit against the National City Company; admits that petitioner received the net amount of $32,384.80 in 1939 on account of the institution of said suit; denies the remaining allegations contained in subparagraph (c) of paragraph V of the petition.

V. (d) Denies the allegations contained in subparagraph (d) of paragraph V of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore specifically admitted, qualified or denied.

Wherefore, respondent prays that the Board redetermine the deficiency herein to be the amount determined by the Commissioner, viz: $7,490.86 in respect of income taxes for the taxable year 1939.

(Signed) J. P. Wenchel, S. U. H., Chief Counsel, Bureau of Internal Revenue.

Of Counsel: F. R. Shearer, Division Counsel; S. U. Hiken, Special Attorney, Bureau of Internal Revenue.

[fol. 40] UNITED STATES BOARD OF TAX APPEALS

Docket No. 106567

E. W. DOBSON, Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

John W. Windhorst, Esq., and Leland W. Scott, Esq., for the petitioner.

S. U. Hiken, Esq., for the respondent.

MEMORANDUM OPINION

TURNER: The respondent determined a deficiency in income tax for the year 1939 in the amount of $7,490.86. The issue presented is whether a sum of money, or any part thereof, recovered by the petitioner in the taxable year as a result of litigation involving certain stock transactions in prior years constitutes a return of capital, as contended by petitioner, or taxable income, as contended by the respondent. The parties have filed a written stipulation of facts

with certain exhibits attached and the Board adopts such stipulation as its findings of fact. We shall recite only the facts deemed necessary to discussion of the issue presented.

Petitioner, a resident of Wayzata, Minnesota, filed his 1939 income tax return with the collector of internal revenue at St. Paul, Minnesota.

At various times in 1928, 1929, and 1931 the petitioner purchased, in transactions entered into for profit, a total of 600 shares of the capital stock of the National City Bank of New York. The stock also carried certain beneficial interests in the stock of the National City Company of New York. The purchases were made in the State of Minnesota from the National City Company.

In 1929 the petitioner sold 200 shares of the stock which had cost him $76,350 for $74,000, thereby sustaining a loss of $2,350. This loss was not claimed as a deduction by the petitioner in his 1929 income tax return because of the wash-sales provisions of the Revenue Act of 1928, and it would not have been allowed if it had been claimed.

In 1930 petitioner sold 200 shares of the stock which had cost him $70,000 for $20,697.44, thereby sustaining a loss in the amount of $49,302.56, which loss was claimed as a deduction in his return for 1930. Although the deductible loss [fol. 41] actually sustained on this sale was $2,350 greater than that claimed by the petitioner in his return, because of the increased basis resulting from the 1929 wash-sale, the deduction actually claimed by petitioner in his return of 1930 was not disturbed by the respondent because the return showed a net loss.

In 1931 the petitioner sold the remaining 200 shares of the stock which had cost him $17,700 for $16,000 thereby sustaining a deductible loss for income tax purposes in the amount of $1,700. This loss was claimed by petitioner as a deduction from gross income in his return for 1931 and was allowed as a deduction by the respondent.

Until September 1937 the petitioner regarded the aforesaid purchases and sales as closed and completed transactions. During that month petitioner learned for the first time that the stock had not been registered under the Minnesota Blue Sky laws, and further learned for the first time facts which led him to believe that the sales by the company to him might have been fraudulent. On July 9, 1938 he filed a suit against National City Company in an effort to recover the amounts which he had paid for the stock in

1928, 1929 and 1931, alleging that the stock had been sold to him without having been registered in accordance with the requirements of the Minnesota Blue Sky laws and that the sales had been fraudulent. He asked for a rescission of the entire transaction and tendered to the defendant company the proceeds of the stock or an equivalent number of shares of stock of the bank, plus interest and dividends received.

In 1939 the suit was settled by a net payment of $32,384.80 by the company to the petitioner, and upon receipt thereof the suit was dismissed with prejudice pursuant to a stipulation between the parties. Of the total net recovery $31,432.80 is allocable to the stock sold by petitioner in 1930 and the balance of $952 is allocable to the stock sold by petitioner in 1931. It is conceded that the last amount mentioned constituted taxable income to the petitioner for the year 1939 and was reported as income in his return for that year.

Of the deduction of $49,302.56 which was claimed and allowed on petitioner's 1930 income tax return, $5,983.51 thereof is attributable to 40 shares of stock which had been purchased by petitioner in 1928 and none of the recovery by petitioner in 1939 was attributable to such loss. If the balance of the deduction, $43,319.05, had been disallowed no deficiency in petitioner's income tax liability for 1930 would have resulted, as shown by the following computation:

[fol. 42] Net loss per return		($30,197.56)
Add loss claimed on sale of National City Bank stock with respect to which Petitioner made a recovery in 1939		43,319.05
Net income revised		13,121.49
Less:		
Dividends	$13,130.60	
Personal exemption	00.00	
Credit for dependents	00.00	
Total		13,130.60
Balance subject to normal tax		None
Normal tax: 1½% on first $4,000		None
Surtax on $13,121.49		31.21
Less earned income credit		39.25
Total tax assessable		None

If the petitioner had received $31,432.80 on the sale of the stock in 1930 in addition to the amount actually received on such sale, the said $31,432.80 being the amount actually recovered in respect of such stock by reason of the settlement in 1939, his 1930 loss on the sale of the stock would have been $20,219.76, and he would have had no income tax liability for that year, as shown by the following computation:

Net income as shown in original return		($30,197.56)
Add: Entire amount recovered in 1939 in reduction of loss on stock sold in 1930		31,432.80
Net income revised		1,235.24
Less:		
Dividends	$13,130.60	
Personal exemption	00.00	
Total		13,130.60
Balance subject to normal tax		None
Total tax assessable		None
Tax assessed		None
Deficiency		None

Throughout the year 1939 adjustment of petitioner's income tax liability for 1930 was barred by the statute of limitations.

In his income tax return for 1939 the petitioner reported income of only $952 on account of the recovery of $32,384.80. In the deficiency notice the respondent adjusted the amount of gross income reported by adding thereto $31,432.80, thereby treating the entire amount of petitioner's net recovery of $32,384.80 as gross income.

Petitioner contends that the suit brought by him against the National City Company was in the nature of an action for rescission of the original contract and that the amount recovered in 1939 is in the nature of a capital recovery which [fol. 43] does not constitute taxable income in the absence of realization of gain, either actual or constructive, and that he realized no gain since the deduction claimed in the year the stock was sold did not result in any "tax benefit" to him. In the alternative, petitioner contends that if the amount recovered is taxable to him, it is taxable as capital

gain. The respondent contends that the entire amount recovered by the petitioner from the company is taxable as ordinary gain and that it is wholly immaterial whether he realized any "tax benefit" from the deduction taken in the prior year, but that in any event, he did realize a "tax benefit" to the extent that the deduction taken in the prior year offset taxable income.

We have considered this same question in the case of Estate of James N. Collins, 46 B. T. A.—(March 27, 1942), and in that case was held that since the deduction taken by the taxpayer in the prior year did not effect an offset of taxable income, the subsequent recovery in the taxable year did not constitute taxable income. In the instant case the record shows that in 1930 petitioner claimed a loss deduction on account of the transaction in the amount of $49,302.56, and after taking such deduction his return showed a net loss of $30,197.56, and further, that the loss actually sustained by petitioner on the transaction was $2,350 greater than that claimed. Had that additional sum been claimed as a deduction, his return would have shown a net loss of $32,547.56. Therefore, to that extent the loss sustained upon the sale of the stock in the prior year did not effect an offset of taxable income, and since his recovery of $31,432.80 in the taxable year is less than said loss we hold that no part thereof constitutes taxable income. Cf. John V. Dobson, 46 B. T. A.—(March 27, 1942).

Decision will be entered for petitioner.

Entered: March 30, 1942.

UNITED STATES BOARD OF TAX APPEALS, WASHINGTON

Docket No. 106567

E. W. DOBSON, Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

DECISION

Pursuant to the determination of the Board, as set forth in its Memorandum Opinion, entered March 30, 1942, it is

[fol. 44] ordered and decided that there is no deficiency in income tax for the calendar year 1939.

Enter:

Entered Mar. 30, 1942.

(Signed) J. E. Murdock, Member.

UNITED STATES BOARD OF TAX APPEALS

Docket No. 106567

E. W. DOBSON, Petitioner

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

STIPULATION OF FACTS

It is hereby stipulated and agreed by and between the parties hereto, by their respective counsel, that the following facts shall be taken as true, provided, however, (1) that each of the parties hereto reserves the right to object to the admissibility in evidence of any such facts on the ground of irrelevancy and immateriality and (2) that this stipulation shall be without prejudice to the right of either party to introduce other and further evidence not inconsistent herewith:

I

Petitioner, a resident of Wayzata, Minnesota, filed, within the time required by law, his 1939 Federal income tax return with the Collector of Internal Revenue at St. Paul Minnesota.

II

At various times in 1928, 1929, and 1931, the Petitioner purchased, in transactions entered into for profit, a total of 600 shares of the capital stock of National City Bank (hereinafter referred to as the stock), the purchases carrying with them, at no additional cost, proportionate bene-

ficial interests in the stock of National City Company (of New York). In 1933 the name of the latter company was changed to City Company of New York, Inc. These purchases were made by the petitioner in the State of Minnesota from the National City Company.

III

In 1929 the petitioner sold 200 shares of said stock, which had cost him $76,350.00, for $74,000.00, thereby sustaining a loss of $2,350.00. This loss was not claimed by the petitioner in his 1929 Federal income tax return because of the [fol. 45] wash-sales provisions of the Revenue Act of 1928, nor would it have been allowable if it had been claimed.

IV

In 1930 Petitioner sold 200 shares of the stock, which had cost him $70,000.00, for $20,697.44, thereby sustaining a loss in the amount of $49,302.56. This is the amount of the loss which was claimed as a deduction in the petitioner's income tax return for 1930. Although for income tax purposes the deductible loss sustained on this sale was $2,350.00 greater than that claimed by the petitioner, in view of the increased basis resulting from the 1929 wash-sale, the deduction actually claimed by petitioner in his return for 1930 was not disturbed by the respondent on an examination of said return because the return showed a net loss.

V

In 1931 the petitioner sold the remaining 200 shares of said stock, which had cost him $17,700.00, for $16,000.00, thereby sustaining a deductible loss for Federal income tax purposes in the amount of $1,700.00. This loss was claimed by petitioner as a deduction from gross income in his Federal income tax return for 1931 and the loss was allowed as a deduction by the respondent.

VI

Until September 1937, the Petitioner regarded the aforesaid purchases and sales as closed and completed transactions. In September 1937, the Petitioner learned for the

first time that said stock had not been registered under the Minnesota Blue Sky laws and the Petitioner also learned for the first time of facts which led him to believe that said sales might have been fraudulent. On July 9, 1938, the Petitioner filed a suit against National City Company in an effort to recover the amounts which he paid for the stock in 1928, 1829, and 1931. The Petitioner's contentions in said action were (1) that the stock had been sold to him without having been registered in accordance with the requirements of the Minnesota Blue Sky laws and (2) that the sales had been fraudulent. A copy of the complaint in said action is attached hereto, marked Exhibit A, and made a part hereof the same as if fully set forth herein.

VII

This suit was settled by the payment to Petitioner in 1939 of $32,384.80 net after the payment by him of attorneys' fees and other similar expenses. Upon payment of said sum said action was dismissed with prejudice pursuant to a [fol. 46] stipulation between the parties thereto. A true and correct copy of said stipulation for dismissal, marked Exhibit B, is attached hereto and made a part hereof the same as if fully set forth herein. Of said total net recovery $31,432.80 is allocable to the stock sold by the petitioner in 1930 (see paragraph IV supra) and the balance, or $952.00, is allocable to the stock sold by Petitioner in 1931. It is conceded that the last mentioned amount constituted taxable income to the Petitioner for the calendar year 1939 and said amount was included as such in Petitioner's return for said year.

VIII

In his Federal income tax return for 1939 the Petitioner reported income of only $952.00 (see paragraph VII supra) on account of the receipt of said $32,384.80. In the deficiency notice from which the appeal herein was taken the Respondent adjusted the amount of the income reported by the Petitioner on said recovery by adding $31,432.80 thereto, thereby treating the entire amount of petitioner's net recovery of $32,384.80 as gross income, 100 per cent taxable.

IX

Of the deduction of $49,302.56 which was claimed and allowed on Petitioner's 1930 Federal income tax return (see paragraph IV supra) $5,983.51 thereof is attributable to 40 shares of stock which had been purchased by Petitioner in 1928 and none of the recovery by Petitioner in 1939 from National City Company was attributable to such loss. If the balance of said deduction of $49,302.56, viz, $43,319.05, had been disallowed, no deficiency in Petitioner's Federal income tax liability for 1930 would have resulted as shown by the following computation:

Net loss per return		($30,197.56)
Add loss claimed on sale of National City Bank stock with respect to which Petitioner made a recovery in 1939		43,319.05
Net income revised		$13,121.49
Less:		
Dividends	$13,130.60	
Personal exemption	00.00	
Credit for dependants	00.00	
Total		13,130.60
Balance subject to normal tax		None
Normal tax: 1½% on first $4,000		None
Surtax on $13,121.49		31.21
Total		31.21
Less earned income credit		39.25
Total tax assessable		None

[fol. 47] Throughout the year 1939 adjustment of Petitioner's Federal income tax liability for 1930 was barred by the statute of limitations.

X

If the Petitioner had received $31,432.80 on the sale of the stock in 1930 in addition to the amounts received upon the sale of the stock as set forth in paragraph IV, supra, his 1930 loss on the sale of said stock would have been $20,-

219.76 and his Federal income tax liability for 1930 would have been zero, computed as follows:

Net income as shown in original return		($30,197.56)
Add: Entire amount recovered in 1939 in reduction of loss on stock sold in 1930		31,432.80
Net income revised		1,235.24
Less:		
Dividends	$13,130.60	
Personal exemption	00.00	
Total		13,130.60
Balance subject to normal tax		None
Total tax assesable		None
Tax assessed		None
Deficiency		None

XI

Photostats of the Petitioner's Federal income tax returns for the years 1930 and 1939 are attached hereto, marked Exihibits C and D, respectively, and made a part hereof the same as if fully set forth herein. The income, deductions and credits for the year 1930, which are set forth in said return are true and correct, except that said return does not show the increased basis for computing loss on the sale of the stock in 1930 on account of the 1929 wash-sale referred to in paragraph IV, supra.

Leland W. Scott, John W. Windhorst, Counsel for Petitioner. (Signed) J. P. Wenchel, D. A. T., Chief Counsel, Bureau of Internal Revenue, Counsel for Respondent.

[fol. 48] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

B. T. A. Docket No. 106567

GUY T. HELVERING, Commissioner of Internal Revenue, Petitioner on Review

vs.

E. W. DOBSON, Respondent on Review

PETITION FOR REVIEW

To the Honorable Judges of the United States Circuit Court of Appeals for the Eighth Circuit:

Guy T. Helvering, Commissioner of Internal Revenue, holding office by virtue of the laws of the United States, hereby petitions for review by the United States Circuit Court of Appeals for the Eighth Circuit of the decision entered by the United States Board of Tax Appeals on March 30, 1942, ordering and deciding that there is no deficiency in income tax for the year 1939 due from the taxpayer, E. W. Dobson, the respondent on review. The taxpayer's income tax return for the year 1939 was filed with the Collector of Internal Revenue for the District of Minnesota, located at St. Paul, Minnesota.

The question presented is whether the taxpayer received taxable income in the amount of $31,432.80 which is an allocable portion of the sum of $32,384.80 received by him in 1939 in compromise of a suit filed against the National City Company of New York for rescission of contracts entered into in 1928 and 1929 for the purchase of bank stock. The taxpayer sold part of the stock in 1930 at a loss which he claimed as a deduction in his income tax return for that year. Until September 1937 the taxpayer regarded the purchases and sales of the stock as closed and completed transactions, but upon learning that the stock had not been registered under the Massachusetts Blue Sky Laws, instituted the suit which led to the recovery in 1939 of the sum of $32,384.80, of which he concedes $952.00 allocable to the stock sold in 1931 constitutes taxable income. The balance of the recovery amounting to $31,432.80 was not reported as taxable income by the taxpayer and was included in

taxable income in the notice of deficiency issued by the Commissioner.

The United States Board of Tax Appeals reversed the Commissioner's determination and held that the sum of $31,432.80 is not includible in taxable income for 1939 for [fol. 49] the reason that the taxpayer did not derive a tax benefit from the deduction of the loss taken in 1930.

The Commissioner avers that in the record and proceedings before the United States Board of Tax Appeals and in the opinion and decision rendered and entered by the United States Board of Tax Appeals manifest error occurred and intervened to the prejudice of the Commissioner who now assigns the following points on which he intends to rely in this proceeding:

The United States Board of Tax Appeals erred—

(1) In holding and deciding that no part of $31,432.80 recovered by the taxpayer in 1939 in settlement of a suit for rescission of contracts for the purchase of stock in 1928 and 1929, which stock was sold in 1930 and losses therefrom were claimed and allowed as deductions from gross income in determining the income tax liability of the taxpayer for the year 1930, should be included in the taxpayer's gross income for 1939.

(2) In failing to hold and decide that $31,432.80 of the amount recovered by the taxpayer in 1939 in settlement of a suit for rescission of contracts for the purchase of bank stock in 1928 and 1929, which stock was sold in 1930 and losses therefrom were claimed and allowed as deductions from gross income in determining the income tax liability of the taxpayer for the year 1930, constituted taxable income for 1939.

(3) In entering its decision wherein it ordered and decided that there is no deficiency in income tax due from this taxpayer for the calendar year 1939.

(4) In failing and refusing to enter its decision redetermining that there is a deficiency in income tax due from the taxpayer in the amount of $7,490.86 for the taxable year 1939.

(5) In that its decision is not supported by the evidence.

(6) In that its decision is contrary to law and regulations.

Samuel O. Clark, Jr., *Assistant Attorney General*, (Signed J. P. Wenchel, R. L. W. *Chief Counsel, Bureau of Internal Revenue, Attorneys for Petitioner on Review.*

RET/mer 6/10/42.

[fol. 50] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

B. T. A. Docket No. 106567

GUY T. HELVERING, Commissioner of Internal Revenue, Petitioner on Review

vs.

E. W. DOBSON, Respondent on Review

United States Board of Tax Appeals, July 1, 1942

NOTICE OF FILING PETITION FOR REVIEW

To Leland W. Scott, Esquire, John W. Windhorst, Esquire, 1300 First National-Soo Line Building, Minneapolis, Minnesota:

You are hereby notified that the Commissioner of Internal Revenue did, on the 22nd day of June 1942, file with the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Eighth Circuit of the decision of the Board heretofore rendered in the above-entitled cause. A copy of the petition for review as filed is hereto attached and served upon you.

Dated this 22nd day of June 1942.

(S.) B. D. Gamble, Clerk, United States Board of Tax Appeals.

Personal service of the above and foregoing notice, together with a copy of the petition for review mentioned therein is hereby acknowledged this 29th day of June 1942.

(S) Leland W. Scott, Attorney for Respondent on Review (S.) John W. Windhorst, Attorney for Respondent on Review.

ENT/mer 6/10/42.

[fol. 51] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

B. T. A. Docket No. 106567

GUY T. HELVERING, Commissioner of Internal Revenue, Petitioner on Review

vs.

E. W. DOBSON, Respondent on Review

Received Aug. 21, 1942. U. S. Board of Tax Appeals

PRAECIPE FOR RECORD

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit, and deliver to the Clerk of the United States Circuit Court of Appeals for the Eighth Circuit, copies duly certified as correct of the following documents and records in the above-entitled cause in connection with the petition for review by the said Circuit Court of Appeals for the Eighth Circuit, heretofore filed by the Commissioner of Internal Revenue:

1. Docket entries of the proceedings before the Board.

2. Pleadings before the Board: (a) Petition, including annexed copy of deficiency letter; (b) Answer.

3. Findings of fact, opinion and decision of the Board.

4. Stipulation of facts.

5. Petition for review, together with proof of service of notice of filing petition for review and of service of a copy of petition for review:

6. Orders enlarging time for the preparation of the evidence and for the transmission and delivery of the record not included in record.

7. This praecipe.

(Signed) J. P. Wenchel, R. L. W. J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue.

Service of a copy of the within praecipe is hereby admitted this 18 day of August 1942.

(S.) Leland W. Scott, (S.) John W. Windhorst, Attorneys for Respondent on Review.

[fol. 52] UNITED STATES BOARD OF TAX APPEALS, WASHINGTON

Docket No. 106567

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

v.

E. W. DOBSON, Respondent

CERTIFICATE

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 69, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at-peals, at Washington, in the District of Columbia, this 1st day of September 1942.

B. D. Gamble, Clerk, United States Board of Tax Appeals. (Seal.)

UNITED STATES BOARD of TAX APPEALS

Docket No. 106553

JOHN V. DOBSON, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 106553

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

v.

E. W. DOBSON, Respondent

ORDER ENLARGING TIME

For cause appearing of record, it is ordered that the time for transmission and delivery of the record *sur* petition for

review of the above entitled proceeding in the United States [fol. 53] Circuit Court of Appeals, Eighth Circuit, is extended to October 8, 1942.

(Signed) John W. Kern, Member.

Dated: Wash., D. C., Aug. 19, 1942.
1j.

Now, Aug. 31, 1942 the foregoing order is certified from the record as a true copy.

B. D. Gamble, Clerk, U. S. Board of Tax Appeals.

[Endorsed] Filed in U. S. Circuit Court of Appeals on September 2, 1942.

Before United States Board of Tax Appeals

Docket No. 106553

John V. Dobson, Petitioner,

v.

Commissioner of Internal Revenue, Respondent

For Taxpayer: Leland W. Scott, John W. Windhorst.
For Comm'r: S. U. Hiken, Esq.

Docket Entries

1941

Mar. 3—Petition received and filed. Taxpayer notified. Fee paid.
Mar. 3—Copy of petition served on General Counsel.
Mar. 3—Request for Circuit hearing in St. Paul, Minn. filed by taxpayer. 3/3/41 Copy served.
Mar. 31—Answer filed by G. C.
Apr. 3—Copy of answer served on taxpayer. (St. Paul, Minn.)
Apr. 28—Hearing set June 16, 1941, St. Paul, Minn.
June 18—Hearing had before Mr. Turner on the merits submitted. Stipulations as to the facts filed. Briefs due Aug. 2, 1941. Reply briefs August 18, 1941.
July 25—Brief filed by taxpayer.
July 28—Motion for extension to Aug. 15, 1941 to file brief filed by G. C. 7/31/41 Granted.

Aug. 2—Transcript of hearing 6/18/41 filed.
Aug. 11—Motion for additional extension to Aug. 30, 1941 to file brief filed by G. C.
[fol. 54]
Aug. 14—Motion for additional extension to Aug. 30, 1941 to file brief granted.
Aug. 29—Brief filed by G. C.
Sept. 2—Copy of brief served on G. C.
Sept. 13—Reply brief filed by taxpayer. 9/15/41 copy served.

1942

Mar. 27—Opinion rendered. Turner, Div. 8. Decision will be entered under Rule 50. 3/30/42 Copy served.
Apr. 17—Agreed computation filed.
Apr. 22—Decision entered. Murdock, Div. 3.
July 10—Petition for review by U. S. Cir. Ct. of Ap. 8th Circuit filed by G. C.
July 21—Proof of service filed by G. C.
July 20—Petition for review by U. S. Cir. Ct. of Ap. 8th Circuit with assignments of error filed by taxpayer.
July 22—Proof of service filed.
Aug. 13—Joint designation of record filed.
Aug. 19—Order enlarging time to Oct. 8, 1942 to transmit and deliver the record entered.

UNITED STATES BOARD OF TAX APPEALS

Docket No. 106553

JOHN V. DOBSON, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Received Mar. 3, 1941. U. S. Board of Tax Appeals.

PETITION

The above named Petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his Notice of Deficiency

dated December 26, 1940, and as a basis for the proceeding alleges:

I

The Petitioner, John V. Dobson, is an individual residing in the City of Minneapolis, County of Hennepin, and State of Minnesota. On or about March 15, 1940, Petitioner filed an income tax return for the calendar year 1939 with the Collector of Internal Revenue of the United States in and for the District of Minnesota.

[fol. 55]

II

The Notice of Deficiency, a copy of which, marked Exhibit A, is attached hereto and hereby made a part hereof, was mailed to Petitioner on December 26, 1940. The taxes in controversy are income taxes for the calendar year 1939 asserted against the Petitioner by said notice.

III

The Notice of Deficiency determined that Petitioner's income tax liability for the calendar year 1939 was $11,509.49. Of this amount $2,401.43 was paid by the Petitioner during the calendar year 1940 and Respondent determined a deficiency in Petitioner's income tax liability for the calendar year 1939 in the sum of $9,108.06. The entire amount of said deficiency is in controversy.

IV

The determination of tax set forth in said Notice of Deficiency is based on the following errors:

(a) Respondent erred in determining that the entire amount of $33,404, recovered by Petitioner during the calendar year 1939 from National City Company, constituted income taxable to the Petitioner.

(b) Respondent erred in determining that $33,246.96 of said $33,404 recovered by Petitioner from National City Company did not constitute a return of capital to the Petitioner.

(c) Respondent erred in determining that Petitioner realized income in excess of the sum of $157.04 as the result of the recovery by Petitioner of said $33,404 from said National City Company.

(d) Respondent erred in determining that the income realized by Petitioner as the result of said recovery from National City Company did not constitute capital gain under the provisions of Section 117 of the Internal Revenue Code.

(e) Respondent erred in determining that there is a deficiency in Petitioner's income tax liability for the calendar year 1939.

V

The facts upon which Petitioner relies as a basis for this proceeding are as follows:

(a) On or about the dates and for the amounts set forth below the Petitioner purchased and sold stock of National City Bank of New York:

[fol. 56] 1. On January 17, 1929, Petitioner purchased 50 shares at a cost of $14,050.

2. On April 22, 1929, Petitioner purchased 50 shares at a cost of $18,850.

3. On October 8, 1929, Petitioner purchased 100 shares at a cost of $49,500.

4. On October 29, 1929, Petitioner sold the 200 shares of stock purchased at items 1, 2 and 3 above for $7,400.

5. On October 29, 1929, Petitioner purchased 40 shares at a cost of $14,000.

6. On October 30, 1929, Petitioner sold the 40 shares purchased at item 5 above for $17,999.48.

7. On November 8, 1929, Petitioner purchased 200 shares at a cost of $66,000.

8. On December 3, 1930, Petitioner sold the 200 shares purchased at item 7 above for $20,897.44.

9. On July 3, 1931, Petitioner purchased 200 shares at a cost of $17,700.

10. On July 13, 1931, Petitioner sold 200 shares purchased at item 9 above for $16,000.

The cost of the purchases described above represents the actual cash outlay of the Petitioner and does not necessarily

determine the income tax cost of said stock to the Petitioner inasmuch as some of the above sales represent wash sales of said stock, thereby increasing the cost of subsequent purchases of said stock as required by the Revenue Act of 1928.

(b) On or about March 15, 1931, the Petitioner filed with the collector of Internal Revenue of the United States in and for the District of Minnesota an income tax return for the calendar year 1930. Said income tax return disclosed the following gross income and deductions therefrom:

Income:		
Salaries	$14,500.00	
Dividends on stock of domestic corporations	23,659.45	
Total income		$38,159.45
Deductions:		
Interest paid	$3,273.23	
Taxes paid	875.69	
Bad debts	1,783.00	
Loss on sale of stock of National City Bank of New York	62,012.56	
Total Deductions		67,944.48
Net income		None

Except as hereinafter set forth with respect to the loss arising upon the sale of stock of National City Bank of New York the income and deductions set forth above are a [fol. 57] true and correct statement of Petitioner's net income for the calendar year 1930 and the Respondent has not made any changes therein. The loss sustained on the sale of stock of National City Bank of New York in the sum of $62,012.56, described in said return, was realized from the sale of 200 shares of said stock for the sum of $20,897.44 on December 3, 1930, as set forth at Item V (a) 8 above. In Petitioner's income tax return for said calendar year 1930 the cost of said stock was set forth as $82,910. The correct income tax cost of said stock was $78,857.38 and the Peti-

tioner therefore sustained a loss upon the sale of said stock in 1930 in the sum of $57,673.94.

(c) On or about March 15, 1932, Petitioner filed an income tax return for the calendar year 1931 with the Collector of Internal Revenue of the United States in and for the District of Minnesota. In said return Petitioner disclosed a net income of $17,514.27 and a tax thereon of $125.43 which was paid to said Collector of Internal Revenue during the calendar year 1932. On or about July 13, 1931, Petitioner sold 200 shares of the stock of National City Bank of New York as set forth at Item V (a) 10 above. Petitioner thereby realized a loss of $1,700, none of which was deducted by Petitioner in computing said net income disclosed in said income tax return for the calendar year 1931. Except for the failure to deduct said loss on the sale of said stock, the income deductions and credits set forth in Petitioner's income tax return for the calendar year 1931 are true and correct and the Respondent has not made any changes therein.

(d) During the calendar year 1939 the Petitioner instituted suit against the National City Company for the recovery of the purchase price of stock of National City Bank of New York purchased from said National City Company on April 22, 1929, October 8, 1929, November 8, 1929, and July 3, 1931, as set forth in paragraph V (a) 2, 3, 7, and 9 above. Said suit was dismissed and Petitioner received as consideration for said dismissal the net amount of $33,404. $157.04 of said amount was recovered with respect to 40 shares of the stock purchased on April 22, 1929 (Item V (a) 2 above); $32,294.96 was recovered with respect to 10 shares of the stock purchased on April 22, 1929 (Item V (a) 2 above), the 100 shares of stock purchased on October 8, 1929 (Item V (a) 3 above), and the 200 shares of stock purchased on November 8, 1929 (Item V (a) 7 above); and $952.00 was recovered with respect to the 200 shares of stock purchased on July 3, 1931 (Item V (a) 9 above).

(e) Except for said recovery of $33,404 during the calendar year 1939 Petitioner has not been reimbursed in any [fol. 58] manner for the loss sustained on the sale of stock of National City Bank of New York as set forth in paragraph V (a) above.

Wherefore, Petitioner prays that this Board may hear the proceedings and decide that:

(a) Respondent erred in determining that the entire amount of $33,404, recovered by Petitioner during the calendar year 1939 from National City Company, constituted income taxable to the Petitioner.

(b) Respondent erred in determining that $33,246.96 of said $33,404 recovered by Petitioner from National City Company did not constitute a return of capital to the Petitioner.

(c) Respondent erred in determining that Petitioner realized income in excess of the sum of $157.04 as the result of the recovery by Petitioner of said $33,404 from said National City Company.

(d) Respondent erred in determining that the income realized by Petitioner as the result of said recovery from National City Company did not constitute capital gain under the provisions of Section 117 of the Internal Revenue Code.

(e) Respondent erred in determining that there is a deficiency in Petitioner's income tax liability for the calendar year 1939.

Leland W. Scott, John W. Windhorst, 1300 First National-Soo Line Bldg., Minneapolis, Minnesota, Attorneys for Petitioner.

STATE OF MINNESOTA,
County of Hennepin, ss:

John V. Dobson, being duly sworn, on oath deposes and says that he is the Petitioner in the above entitled action; that he has read the foregoing Petition and knows the contents thereof; that the same is true of his own knowledge, except as to those matters therein stated on information and belief and as to such matters he believes it to be true.

John V. Dobson.

Subscribed and sworn to before me this 27 day of February 1941. W. J. Murphy, Notary Public, Hennepin County, Minn. My Commission expires December 28, 1941. (Notarial seal.)

[fol. 59] EXHIBIT "A" TO PETITION

Office of Internal Revenue Agent in Charge, St. Paul Division, 800 Post Office Bldg.

Treasury Department,
Internal Revenue Service,
St. Paul, Minnesota, Dec. 26, 1940.

Collection District: Minnesota

Mr. John V. Dobson, *2639 Lake of Isles Blvd., Minneapolis, Minnesota.*

SIR:

You are advised that the determination of your income tax liability for the taxable year (x) 1939 discloses a deficiency of $9,108.06 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the internal revenue agent in charge, St. Paul, Minnesota, for the attention of LGE–90D. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully, Guy T. Helvering, Commissioner, by C. W. Rink, Internal Revenue Agent in Charge.

Enclosures: Statement. Form of Waiver.

LGE/mrr.
GPO. 2–17679.

[fol. 60] STATEMENT

Mr. John V. Dobson, 2639 Lake of Isles Boulevard,
Minneapolis, Minnesota

Tax Liability for Taxable Year Ended December 31, 1939

Income tax: Liability $11,509.49; assessed $2,401.43; deficiency $9,108.06.

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated November 5, 1940.

Adjustments to Net Income

Net income as disclosed by return	$24,583.01
Unallowable deductions and additional income:	
(a) Recovery	33,246.96
Net income adjusted	57,829.97

Explanation of Adjustments

(a) In 1929 you purchased 200 shares of National City Bank stock and sold same at a loss in 1930. During 1939 you received a net amount of $33,404.00 in settlement of a suit brought against the National City Company based on contention that the original sale of this stock to you was illegal, being in violation of the securities laws of the State of Minnesota governing such sales.

It is held that his settlement constitutes taxable income in its entirety.

Net amount received	$33,404.00
Reported	157.04
Adjustment	33,246.96

Computation of Tax

Adjusted net income	$57,829.97
Less: Personal exemption	2,500.00
Balance (surtax net income)	55,329.97
Less: Earned income credit—maximum	1,400.00
Balance subject to normal tax	53,929.97
Normal tax at 4%	2,157.20
Surtax on $55,329.97	9,352.29
Total Tax	11,509.49
Total tax assessable	11,509.49
Tax previously assessed—Acct. No. 202181	2,401.43
Deficiency in income tax	9,108.06

[fol. 61] UNITED STATES BOARD OF TAX APPEALS

Docket No. 106553

JOHN V. DOBSON, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Received Mar. 31, 1941. U. S. Board of Tax Appeals

ANSWER

Now comes the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed herein admits, denies and alleges as follows:

I and II. Admits the allegations contained in paragraphs I and II of the petition.

III. Admits that in the notice of deficiency it was determined that petitioner's income tax liability for the calendar

year 1939 is $11,509.49; admits that respondent determined a deficiency in petitioner's income tax liability for the calendar year 1939 in the sum of $9,108.06; admits that the entire amount of said deficiency is in controversy; denies the remaining allegations contained in paragraph III of the petition.

IV. (a) to (e), inclusive. Denies that the respondent erred as alleged in subparagraphs (a) to (e), inclusive, of paragraph IV of the petition.

V. (a) Admits that sometime in 1929 the petitioner purchased 200 shares of stock of National City Bank; admits that the petitioner sold said stock at a loss in 1930; denies the remaining allegations contained in subparagraph (a) of paragraph V of the petition.

V. (b) Denies the allegations contained in subparagraph (b) of paragraph V of the petition, except it is admitted that in 1930 the petitioner sustained a substantial loss, the exact amount of which is unknown to the respondent, on the sale sometime in that year of 200 shares of National City Bank stock purchased by the petitioner sometime in 1929.

V. (c) Denies the allegations contained in subparagraph (c) of paragraph V of the petition.

V. (d) Admits that during the calendar year 1939 the petitioner instituted a suit against the National City Company; admits that petitioner received the net amount of $33,404.00 in 1939 on account of the institution of said suit; [fol. 62] denies the remaining allegations contained in subparagraph (d) of paragraph V of the petition.

V. (e) Denies the allegations contained in subparagraph (e) of paragraph V of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore specifically admitted, qualified or denied.

Wherefore, respondent prays that the Board redetermine the deficiency herein to be the amount determined by the Commissioner, viz.: $9,108.06 in respect of income taxes for the taxable year 1939.

(Signed) J. P. Wenchel, S. U. H., J. P. Wenchel,
Chief Counsel, Bureau of Internal Revenue.

Of Counsel: F. R. Shearer, Division Counsel; S. U. Hiken, Special Attorney, Bureau of Internal Revenue.

UNITED STATES BOARD OF TAX APPEALS

JOHN V. DOBSON, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 106553. Promulgated March 27, 1942

By reason of a loss in 1930 on the sale of certain bank stock, deduction for which was claimed and allowed, petitioner sustained and reported a net loss for that year. Charging fraud, he brought suit in 1938 for rescission of the contract whereby the said bank stock had been purchased. In 1939 he received in settlement of the said suit, an amount less than the loss sustained on the sale of stock but greater than his 1930 net loss. *Held*, that the amount recovered in 1939 constitutes taxable income in the year of recovery to the extent that the amount recovered is in excess of the 1930 net loss, and that such income is taxable as ordinary income.

John W. Windhorst, Esq., and Leland W. Scott, Esq., for the petitioner.

S. U. Hiken, Esq., for the respondent.

[fol. 63] OPINION

Turner: The respondent determined a deficiency in income tax for the year 1939 in the amount of $9,108.06. The question presented is whether a sum of money, or any part thereof, recovered by the petitioner in the taxable year as a result of litigation involving certain stock transactions in prior years constitutes a return of capital, as contended by petitioner, or taxable income, as contended by respondent. The parties have filed a written stipulation of facts, with certain exhibits attached thereto, and the Board adopts such stipulation as its findings of fact. We shall recite only the facts deemed necessary to discussion of the issue presented.

Petitioner, a resident of Minneapolis, Minnesota, filed his 1939 income tax return with the collector of internal revenue for the district of Minnesota.

At various times in 1929 petitioner purchased, in transactions entered into for profit, a total of 440 shares of the capital stock of the National City Bank of New York. The stock also carried certain beneficial interests in the stock of

the National City Co. of New York. The purchases were made in the State of Minnesota from the National City Co.

During the year 1929 petitioner sold a total of 240 shares of the stock, 90 shares of which resulted in a taxable gain of $8,168.44 and was so treated in closing petitioner's income tax liability for 1929. The sale of the remaining 150 shares in 1929 resulted in a loss of $13,168.44, properly disallowed as a deduction in closing petitioner's 1929 income tax liability because of the wash sales provisions of the Revenue Act of 1928.

In 1930 petitioner sold the remaining 200 shares of the stock for $20,897.44. These shares had actually cost the petitioner $70,000, but, because of the wash sales in 1929 which resulted in nondeductible losses for that year, the petitioner's basis for determining the amount of loss sustained in 1930 was $70,000 plus $13,168.44, or $83,168.44. The 1930 sale resulted in a deductible loss by the petitioner in the amount of $62,271, which was allowed by the respondent as a deduction in closing petitioner's income tax liability for that year.

On July 3, 1931, petitioner purchased 200 shares of the bank stock at a cost of $17,700, and on July 13, 1931, sold the said shares for $16,000, thereby sustaining a loss of $1,700 which was deductible for 1931, but was not claimed as a deduction. Upon audit of the return, no deduction was allowed by the respondent by reason of the loss realized on the sale, but had such loss been claimed as a deduction it would have been allowed by the respondent and would have re- [fol. 64] duced the income tax liability of petitioner for the year 1931, but would not have eliminated entirely liability to tax. Petitioner's 1931 return disclosed net income of $17,514.27, and a tax thereon of $125.43, which was paid to the collector during the year 1932.

Until September 1937 the petitioner regarded the aforesaid purchases and sales as closed and completed transactions. During that month petitioner learned for the first time that the stock had not been registered under the Minnesota Blue Sky Laws, and further learned for the first time facts which led him to believe that the sales by the company to him might have been fraudulent. On or about July 9, 1938, the petitioner filed a suit against the National City Co. in an effort to recover the amounts which he had paid for the stock in 1929 and 1931, alleging that the stock had been sold to him without having been registered in accordance

with the requirements of the Minnesota Blue Sky Laws and that the sales had been fraudulent. He asked for a decission of the entire transaction and tendered to the defendant company the proceeds of the stock or an equivalent number of shares of stock of the bank, plus interest and dividends received.

In 1939 the suit was settled by a net payment of $33,404 by the company to the petitioner, and upon receipt thereof the suit was dismissed, with prejudice, pursuant to a stipulation between the parties. Of the total net recovery, $157.04 related to 40 shares of stock which are not here involved and is conceded to be taxable income. Of the remainder, $32,294.96 is allocable to the stock sold by the petitioner in 1930 and the balance of $952 is allocable to the stock sold by petitioner in 1931.

If the entire deduction of $62,271, allowed as a deduction in connection with petitioner's 1930 Federal income tax liability had been disallowed, there would have been net income in the amount of $32,227.53 and a deficiency in petitioner's income tax for 1930 would have resulted in the amount of $1,232.75, computed as follows:

Net loss		($30,043.47)
Add: Loss on National City Bank stock, eliminated		62,271.00
Net income revised		32,227.53
Less:		
Dividends	$23,659.45	
Personal exemption	3,500.00	
Credit for dependents	1,200.00	28,359.45
		3,868.08
Normal tax: 1½% of $3,868.04		$57.02
Surtax on $32,227.53		1,240.48
Total		1,297.50
[fol. 65] Less: Earned income credit		$64.75
Total tax assessable		1,232.75
Assessed		0.00
Deficiency		1,232.75

If in addition to the $20,897.44 actually received on the sale of the stock in 1930 petitioner had received $32,294.96, being the amount recovered in 1939 in respect of the stock sold in 1930, his deductible loss for 1930 from the sale of the said stock would have been $29,976.04 and he would have had net income in the amount of $2,251.49. Due to certain credits allowable, however, his income tax for 1930 would have been zero, shown as follows:

Net loss		($30,043.47)
Add: Entire amount recovered in 1939 in reduction of loss on stock sold in 1930		32,294.96
Net income revised		2,251.49
Less:		
Personal exemption	$3,500.00	
Credit for dependents	1,200.00	
Total		4,700.00
Balance subject to tax		none
Total tax assessable		none
Tax assessed		none
Deficiency		none

Throughout the year 1939 adjustment of petitioner's income tax liability for 1930 was barred by the statute of limitations.

In his income tax return for 1939 the petitioner reported income of only $157.04 on account of the recovery of $33,404. In the deficiency notice the respondent adjusted the amount of gross income reported by adding $33,246.96 and thereby treating the entire amount of petitioner's net recovery of $33,404 as ordinary income.

Since addition to 1930 income of an amount equal to that recovered in 1939 in respect of the stock sold in 1930 would not have resulted in any amount of income tax for 1930, it is the claim of the petitioner that no part of the said recovery constituted taxable income for 1939, even though the loss deduction of $62,271 claimed and allowed for 1930 in respect of the said sale did serve to offset taxable income in the amount of $32,227.53, and even though there would have

been net income in 1930 in the amount of $2,251.49 instead of a net loss if upon the sale of stock in that year petitioner had received an additional amount equal to that recovered in 1939. In the alternative, petitioner contends that if the amount recovered is taxable it is taxable as capital gain. The respondent contends that the amount recovered by the petitioner which is allocable to the 1930 sale is taxable as [fol. 66] ordinary gain and that it is wholly immaterial whether petitioner realized any tax benefit from the deduction taken in the prior year but that in any event the petitioner did realize a tax benefit to the extent that the deduction taken in the prior year operated to offset taxable income.

In Estate of James N. Collins, 46 B. T. A.—(Mar. 27, 1942), concurrently decided, we have considered the nature and character of transactions and recoveries such as are here involved and have reviewed the controlling decisions. Where there is recovery in respect of a loss sustained in an earlier year and a deduction of such loss claimed and allowed for the earlier year had effected an offset in taxable income, the amount recovered in the later year should be included in taxable income for the year of recovery, the reason being that even though the subsequent recovery is in the nature of a capital recovery the prior deduction of the amount of the loss from taxable income has for income tax purposes already given the taxpayer a recoupment of said loss out of taxable income and the subsequent recovery, being in the nature of a replacement of taxable income, is equivalent to gain to the taxpayer. National Bank of Commerce of Seattle v. Commissioner, 115 Fed. (2d) 875, affirming 40 B. T. A. 72. But where the deduction claimed and allowed in the prior year did not effect an offset of taxable income, the amount recovered in a later year does not constitute taxable income for the year of recovery. Estate of James N. Collins, supra. In the instant case the deduction for 1930 of the loss sustained upon the sale of the National City Bank stock resulted in a net loss to the petitioner for that year of $30,043.57, and to that extent the loss deduction claimed in 1930 did not effect an offset of taxable income. In 1939 the petitioner recovered in respect of such stock and in addition to the amount received upon its sale in 1930 the amount of $32,294.96. It is accordingly apparent that the deduction in 1930 of the amount recovered in 1939

did effect an offset in taxable income in the amount of $2,251.49, that amount being the excess of the 1939 recovery over the 1930 net less and to that extent the amount recovered in 1939 constitutes taxable income to the petitioner in the year of recovery. Central Loan & Investment Co., 39 B. T. A. 981; Amsco-Wire Products Corporation, 44 B. T. A. 717. Petitioner's contention that the income so realized should be taxed as capital gain is denied on authority of Avery R. Schiller, 43 B. T. A. 594.

With respect to the $952 recovered in 1939 in respect of the stock sold in 1931, the respondent on brief states: "For the purposes of the present case the respondent does not [fol. 67] press the issue that the amount of $952.00 of the recovery allocable to the stock which was sold in 1931 and on which no loss was claimed, constitutes taxable income, inasmuch as the principle enunciated in G. C. M. 22163, 1940-2 Cum. Bull. 76 is to the contrary."

Decision will be entered under Rule 50.

UNITED STATES BOARD OF TAX APPEALS, WASHINGTON

Docket No. 106553

JOHN V. DOBSON, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

DECISION

Pursuant to the Findings of Fact and Opinion of the Board promulgated March 27, 1942, the parties herein having on April 17, 1942, filed an agreed recomputation of tax in accordance therewith, it is

Ordered and decided: That there is a deficiency in income tax for the year 1939 in the amount of $472.82.

(S.) J. E. Murdock, Member.

Entered April 22, 1942.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

B. T. A. Docket No. 106553

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner on Review,

vs.

JOHN V. DOBSON, Respondent on Review

Received July 10, 1942, U. S. Board of Tax Appeals.

PETITION FOR REVIEW

To the Honorable Judges of the United States Circuit Court of Appeals for the Eighth Circuit:

Guy T. Helvering, Commissioner of Internal Revenue, holding office by virtue of the laws of the United States, hereby petitions for review by the United States Circuit Court of Appeals for the Eighth Circuit of the decision [fol. 68] entered by the United States Board of Tax Appeals on April 22, 1942, ordering and deciding that there is a deficiency of $472.82 in income tax for the year 1939 due from the taxpayer, John V. Dobson, the respondent on review. The taxpayer's income tax return for the year 1939 was filed with the Collector of Internal Revenue for the District of Minnesota, located at St. Paul, Minnesota.

The question presented is whether the taxpayer received taxable income in the amount of $30,043.57 which is an allocable portion of the sum of $33,404 received by him in 1939 in compromise of a suit filed against the National City Company of New York for rescission of contracts entered into in 1929 and 1931 for the purchase of bank stock. The taxpayer sold part of the stock in 1930 at a loss which he claimed as a deduction in his income tax return for that year. Until September 1937 the taxpayer regarded the purchases and sales of the stock as closed and completed transactions, but upon learning that the stock had not been registered under the Massachusetts Blue Sky Laws, instituted the suit which led to the recovery in 1939 of the sum of $33,404, of which he concedes $157.04 constitutes taxable income, and of which the Commissioner concedes that $952 does not constitute taxable income. The balance of the re-

covery amounting to $32,294.96 was not reported as taxable income by the taxpayer and was included in taxable income in the notice of deficiency issued by the Commissioner.

The United States Board of Tax Appeals reversed the Commissioner's determination and held that only $2,251.49 of the balance of the recovery in the amount of $32,294.96 is includable in taxable income for 1939. The Board refused to sanction the inclusion of any part of the remainder of the recovery amounting to $30,043.57 in taxable income for the year 1939, for the reason that the taxpayer did not derive a tax benefit from the deduction of the loss taken in 1930.

The Commissioner avers that in the record and proceedings before the United States Board of Tax Appeals and in the opinion and decision rendered and entered by the United States Board of Tax Appeals manifest error occurred and intervened to the prejudice of the Commissioner who now assigns the following points on which he intends to rely in this proceeding:

The United States Board of Tax Appeals erred—

(1) In holding and deciding that no part of $30,043.47 recovered by the taxpayer in 1939 in settlement of a suit for rescission of contracts for the purchase of stock in 1929 and 1931, part of which stock was sold in 1930 and losses therefrom were claimed and allowed as deductions from gross [fol. 69] income in determining the income tax liability of the taxpayer for the year 1930, should be included in the taxpayer's gross income for 1939.

(2) In failing to hold and decide that $30,043.47 of the amount recovered by the taxpayer in 1939 in settlement of a suit for rescission of contracts for the purchase of stock in 1929 and 1931, part of which stock was sold in 1930 and losses therefrom were claimed and allowed as deductions from gross income in determining the income tax liability of the taxpayer for the year 1930, constituted taxable income for 1939.

(3) In entering its decision wherein it ordered and decided that there is a deficiency in income tax due from this taxpayer in the amount of $472.82 for the calendar year 1939.

(4) In failing and refusing to enter its decision redetermining that there is a deficiency in income tax due by the taxpayer in the amount of $9,108.06.

(5) In that its decision is not supported by the evidence.

(6) In that its decision is contrary to law and regulations.

(Sgd.) Samuel O. Clark, Jr., Assistant Attorney General; (Signed) J. P. Wenchel, R. L. W., Chief Counsel, Bureau of Internal Revenue, Attorneys for Petitioner on Review.

ERT/mar 6/10/42.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

B. T. A. Docket No. 106553

GUY T. HELVERING, Commissioner of Internal Revenue, Petitioner on Review,

vs.

JOHN V. DOBSON, Respondent on Review

Received, July 21, 1942, U. S. Board of Tax Appeals.

NOTICE OF FILING PETITION FOR REVIEW

To John V. Dobson, 2639 Lake of Isles Blvd., Minneapolis, Minn.:

You are hereby notified that the Commissioner of Internal Revenue did, on the 10th day of July, 1942, file with the [fol. 70] United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Eighth Circuit of the decision of the Board heretofore rendered in the above-entitled cause. A copy of the petition for review as filed is hereto attached and served upon you.

Dated this 10th day of July 1942.

(Signed) J. P. Wenchel, R. L. W., Chief Counsel, Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review mentioned therein is hereby acknowledged this 14th day of July 1942.

(S.) John V. Dobson, Respondent on Review.

RHT/mar 6/24/42.

UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT

B. T. A. Docket No. 106553

JOHN V. DOBSON, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

PETITION FOR REVIEW AND ASSIGNMENTS OF ERROR

To the Honorable Judges of the United States Circuit Court of Appeals for the Eighth Circuit:

Now comes John V. Dobson, by his attorneys, Leland W. Scott and John W. Windhorst, and respectfully shows:

I

JURISDICTION

The petitioner on review is an individual residing in the City of Minneapolis, County of Hennepin, State of Minnesota. The respondent on review holds his office under and by virtue of the laws of the United States. An income tax return was filed by the Petitioner for the calendar year 1939 on or about March 15, 1940, with the Collector of Internal Revenue for the District of Minnesota in St. Paul, Minnesota, whose office is located within the judicial district of the United States Circuit Court of Appeals for the Eighth Circuit.

[fol. 71]

II

NATURE OF CONTROVERSY

On December 26, 1940, the Commissioner forwarded to the Petitioner by registered mail a notice of deficiency wherein the Petitioner was notified of a deficiency in the amount of $9,108.06 in his income tax liability for the year 1939.

Thereafter, on March 3, 1941, the Petitioner filed with the Board of Tax Appeals a petition for redetermination of the proposed deficiency for the year 1939. On March 31, 1941, the Commissioner filed with the Board of Tax Appeals his answer to the petition of the Petitioner. The proceeding came on to be heard before a division of the Board of Tax Appeals sitting in St. Paul, Minnesota, on June 18, 1941.

The questions presented are (1) whether the Petitioner must include in his taxable gross income for the calendar year 1939 the amount of $2,251.49 representing a portion of the amount received in settlement of a suit for rescission of a purchase of National City Bank of New York stock by the Petitioner from National City Company, and (2) if said amount is to be included in Petitioner's taxable income for 1939, whether it is to be treated as ordinary income or as capital gain under Section 117 of the Internal Revenue Code.

On March 27, 1942, the Board of Tax Appeals promulgated its opinion wherein it was held that the Petitioner was taxable on the amount of $2,251.49 of the total received in settlement of damage suits in 1939 and excluded by the Petitioner from the taxable income reported in his return for 1939. The Board further held that said $2,251.49 was taxable as ordinary income rather than capital gain. On April 22, 1942, the board entered its decision and order that there was a deficiency of $472.82 in the Petitioner's income tax liability for the calendar year 1939. On or about April 28, 1942, the Petitioner paid the entire amount of said deficiency, plus interest in the amount of $60.27, to the Collector of Internal Revenue for the District of Minnesota.

The facts shortly stated are as follows: At various times in 1929 the petitioner purchased from National City Company a total of 440 shares of capital stock in the National City Bank of New York. During 1930 the Petitioner sold a portion of this stock for $20,897.44. This stock had cost the Petitioner $83,168.44 and Petitioner thereby sustained a loss on said stock in the sum of $62,271, which amount was allowed by the Commissioner as a deduction in determining the Petitioner's income tax liability for 1930. In [fol. 72] 1938 Petitioner commenced a suit against the National City Company wherein he sought to rescind the purchase of the stock for alleged fraud on the part of the de-

fendant and violations of the Minnesota Blue Sky Law. The action was settled during the year 1939 by a net payment of $33,404 by the National City Company to the Petitioner. Of the amount received in settlement, $32,294.96 is allocable to the stock sold by the Petitioner in 1930. This latter amount was not included in the taxable income reported by Petitioner in his 1939 income tax return. If the deductible loss suffered during 1930 upon the sale of National City Bank stock were reduced by the amount of 1939 recovery allocable to the shares sold during 1930, the 1930 income tax return of the Petitioner would have shown a net income of $2,251.49. Because of a personal exemption in the amount of $3,500 and a credit for dependents in the amount of $1,200, the tax liability of the Petitioner for 1930 under these circumstances would have been zero. The loss on the stock sales in 1930, to the extent compensated for by the 1939 settlement, resulted in no tax saving to the Petitioner.

III

Points upon Which Petitioner Intends to Rely

Petitioner is aggrieved at the decision of the Board of Tax Appeals and says that in the proceeding before the Board and in the opinion and decision aforesaid manifest error occurred and intervened to his prejudice and he assigns as error the following:

1. The Board of Tax Appeals erred in determining that there is a deficiency of $472.82 in Petitioner's income tax liability for 1939, in that its decision is contrary to law.

2. The Board of Tax Appeals erred in finding that a part of the amount received in settlement of the legal action against the National City Company in 1939, to the extent of $2,251.49, was includable in the Petitioner's taxable income for the calendar year 1939 under Section 22 of the Internal Revenue Code.

3. The Board of Tax Appeals erred in finding that a part of the amount received in settlement of the legal action against the National City Company in 1939 in the amount of $2,251.49 was to be treated as ordinary income rather than capital gain under Section 117 of the Internal Revenue Code.

4. The Board of Tax Appeals erred in failing to find that none of the amount recovered in settlement of the legal ac-

tion against the National City Company in 1939 and allocable to the purchase price of stock of National City Bank [fol. 73] of New York which was sold in 1930 was includable in the taxable income of the Petitioner in 1939, under Sec. 22 of the Internal Revenue Code.

5. The Board of Tax Appeals erred in entering judgment that there was a deficiency of $472.82 in the amount of Petitioner's income tax liability for the calendar year 1939, instead of entering judgment of no deficiency for said year, in that the uncontradicted evidence warrants no other conclusion.

Wherefore, The Petitioner requests that the aforesaid decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Eighth Circuit; that a transcript of record be prepared in accordance with law and the rules of this Court and transmitted to the Clerk of said Court for filing; and that appropriate action be taken to the end that errors complained of may be reviewed and corrected by the Court.

Leland W. Scott, John W. Windhorst, Counsel for Petitioner, 1300 First National-Soo Line Building, Minneapolis, Minnesota.

* * * * * * *

Duly sworn to by John W. Windhorst. Jurat omitted in printing.

[fol. 74] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

B. T. A. Docket No. 106553

JOHN V. DOBSON, Petitioner on Review,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent on Review

Received July 22, 1942. U. S. Board of Tax Appeals.

NOTICE OF FILING PETITION FOR REVEIW AND STATEMENT OF POINTS

To J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue:

You are hereby notified that John V. Dobson did, on the 20th day of July 1942, file with the Clerk of the United

States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the — Circuit, of the decision of the Board heretofore rendered in the above entitled case. Copies of the petition for review and the statement of points as filed are hereto attached and served upon you.

Dated this 21st day of July 1942.

(S.) B. D. Gamble, Clerk, U. S. Board of Tax Appeals.

Service of copy of Petition for Review and Statement of Points acknowledged this July 22, 1942.

J. P. Wenchel, Attorney for Respondent.

UNITED STATES BOARD OF TAX APPEALS

Docket No. 106553

JOHN V. DOBSON, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

U. S. Board of Tax Appeals. Filed at hearing June 18, 1941.

STIPULATION OF FACTS

It is hereby stipulated and agreed by and between the parties hereto, by their respective counsel, that the follow- [fol. 75] ing facts shall be taken as true, provided, however, (1) that each of the parties hereto reserves the right to object to the admissibility in evidence of any of such facts on the ground of irrelevancy and immateriality and (2) that this stipulation shall be without prejudice to the right of either party to introduce other and further evidence not inconsistent herewith:

I

Petitioner, a resident of Minneapolis, Minnesota, filed, within the time required by law, his 1939 Federal income tax return with the Collector of Internal Revenue at St. Paul, Minnesota.

II

In 1929 the petitioner purchased at various times, in transactions entered into for profit, a total of 440 shares of the capital stock of National City Bank (hereinafter referred to as the stock), the purchases carrying with them, at no additional cost, proportionate beneficial interests in the stock of National City Company (of New York). In 1933 the name of the latter company was changed to City Company of New York, Inc. These purchases were made by the petitioner in the State of Minnesota from the National City Company.

III

During the year 1929 the petitioner sold a total of 240 shares of said stock. The sale of 90 of such shares resulted in a taxable gain of $8,168.44, so treated in closing petitioner's Federal income tax liability for 1929. The sales of the remaining 150 shares in 1929 resulted in a loss of $13,168,44, properly disallowed as a deduction in closing petitioner's 1929 Federal income tax liability because of the wash-sales provisions of the Revenue Act of 1928.

IV

In 1930 the petitioner sold the remaining 200 shares of said stock for $20,897.44. These shares had actually cost the petitioner $70,000.00, but because of the wash-sales in 1929 which resulted in nondeductible losses for that year the petitioner's basis for determining the amount of the loss which he sustained in 1930, for Federal income tax purposes, was $70,000.00 plus $13,168.44, or $83,168.44. This situation resulted in the realization by the petitioner of a deductible loss in the amount of $62,271.00 for 1930 which [fol. 76] was allowed by the respondent as a deduction in closing petitioner's income tax liability for said year.

V

On July 3, 1931, the petitioner purchased 200 shares of said stock at a cost of $17,700. On July 13, 1931, petitioner sold said 200 shares for $16,000 and thereby sustained a loss of $1,700 which was deductible by petitioner in his income tax return for the calendar year 1931, but which was not claimed by petitioner in his income tax for the calendar year 1931. Upon audit of said return, no amount was al-

lowed by respondent as a deduction by reason of the loss realized on said sales.

VI

Until September 1937, the Petitioner regarded the aforesaid purchases and sales as closed and completed transactions. In September 1937, the Petitioner learned for the first time that said stock had not been registered under the Minnesota Blue Sky laws and the Petitioner also learned for the first time of facts which led him to believe that said sales might have been fraudulent. Thereafter, and on or about July 9, 1938, the petitioner filed a suit against the National City Company in an effort to recover the amounts which he paid for the stock in 1929 and 1931. The petitioner's contentions in that suit were: (1) that the stock had been sold to him without having been registered in accordance with the requirements of the Minnesota Blue Sky laws, and (2) that the sales had been fraudulent. A copy of the complaint in said action is attached hereto, marked Exhibit A and made a part hereof the same as if fully set forth herein.

VII

This suit was settled by the payment to the petitioner in 1939 of $33,404 net, after the payment by him of attorneys' fees and other similar expenses. On March 28, 1939, pursuant to said settlement, a stipulation of dismissal with prejudice was executed by the parties to said action. A copy of said stipulation for dismissal, marked Exhibit B, is attached hereto and made a part hereof the same as if fully set forth herein.

Of said amount of $33,404, the sum of $157.04 was recovered with respect to forty shares of stock which is not here [fol. 77] involved and which is conceded to be taxable income: $32,294.96 of said amount is allocable to stock sold by the petitioner in 1930, and the balance of $952.00 is allocable to the stock sold by petitioner in 1931.

VIII

In his Federal income tax return for the calendar year 1939, the petitioner reported income of only $157.04 on account of the receipt of said $33,404. In the deficiency notice from which the appeal herein was taken, the respondent adjusted the amount of the income reported by the peti-

tioner on said recovery by adding $33,246.96 thereto, thereby treating the entire amount of petitioner's net recovery of $33,404 as gross income 100% taxable.

IX

If the entire deduction of $62,271.00 which was allowed as a deduction in connection with petitioner's 1930 Federal income tax liability had been disallowed, a deficiency in petitioner's Federal income tax liability for 1930 would have resulted in the amount of $1,232.75, computed as follows:

Net loss per R. A. R., May 27, 1932		($30,043.47)
Add:		
Loss on National City Bank stock, eliminated		62,271.00
Net income revised		32,227.53
Less:		
Dividends	$23,659.45	
Personal exemption	3,500.00	
Credit for dependents	1,200.00	
		28,359.45
		3,868.08
Normal tax: 1½ of $3,868.04		57.02
Surtax on $32,227.53		1,240.48
Total		1,297.50
Less:		
Earned income credit		64.75
Total tax assessable		1,232.75
Assessed		0.00
Deficiency		1,232.75

Throughout the year 1939 assessment of this deficiency was barred by the statute of limitations.

X

If the petitioner had received $32,294.96 on the sale of the stock in 1930 in addition to the amount of $20,897.44

[fol. 78] which he actually received, his 1930 deductible loss from the sale of said stock would have been $29,976.04 and his Federal income tax liability for 1930 would have been zero computed as follows:

Net loss per R. A. R. May 27, 1932		(30,043.47)
Add:		
Entire amount recovered in 1939 in reduction of loss on stock sold in 1930		32,294.96
Net income revised		2,251.49
Less:		
Dividends	$23,659.45	
Personal exemption	3,500.00	
Credit for dependents	1,200.00	
Total		28,359.45
Balance subject to normal tax		none
Total tax assessable		none
Tax assessed		none
Deficiency		none.

XI

On or about March 15, 1932, petitioner filed an income tax return for the calendar year 1931 with the Collector of Internal Revenue of the United States, in and for the District of Minnesota. In said return, petitioner disclosed net income of $17,514.27, and a tax thereon of $125.43 which was paid to the Collector of Internal Revenue during the calendar year 1932. The petitioner did not claim the deduction in said return by reason of the loss upon the sale of 200 shares of stock of National City Company realized by petitioner as set forth in Paragraph V supra. Had said loss been claimed by the petitioner, it would have been allowed by the respondent and would have reduced the income liability of petitioner for the calendar year 1931 but would not have eliminated it entirely. Except for the failure to deduct a loss on the sale of said 200 shares of stock of National City Bank, the income deductions and credits set forth in said return were true and correct and the respondent has not made any changes therein.

XII

Photostats of petitioner's Federal income tax returns for the calendar years 1930, 1931 and 1939 are attached hereto, marked Exhibits C, D and E respectively, and made a part hereof the same as if fully set forth herein. The income deductions and credits for the year 1930 are true [fol. 79] and correct as adjusted in the copy of the Revenue Agent's report which is attached to Exhibit C as a part thereof.

Leland W. Scott, John W. Windhorst, Counsel for Petitioner. (Signed) J. P. Wenchel, D. A. T., Chief Counsel, Bureau of Internal Revenue, Counsel for Respondent.

UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT

B. T. A. Docket No. 106553

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, Petitioner,

v.

JOHN V. DOBSON, Respondent

JOHN V. DOBSON, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

JOINT DESIGNATION OF RECORD FOR REVIEW

To the Clerk of the United States Board of Tax Appeals:

You are requested by petitioners in the above-entitled action to prepare, transmit, and deliver to the Clerk of the United States Circuit Court of Appeals for the Eighth Circuit copies, duly certified as correct, of the following documents and records in the above-entitled cause in connection with the Petitions for Reivew heretofore filed by the respective petitioners:

1. Docket entries of proceedings before the Board.
2. Pleadings before the Board.
3. Opinion of the Board promulgated March 27, 1942.

4. Decision entered April 22, 1942.

5. Petition for Review and Statement of Points filed on July 10, 1942, by petitioner, Guy T. Helvering, Commissioner of Internal Revenue, together with notice of filing thereof and proof of service.

[fol. 80] 6. Petition for Review and Statement of Points filed on July 20, 1942, by petitioner, John V. Dobson, together with notice of filing thereof and proof of service.

7. The stipulation of facts agreed upon between the parties.

8. This Designation of Record.

(S.) J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue. Attorney for Guy T. Helvering, Commissioner of Internal Revenue. (S.) Leland W. Scott, John W. Windhorst, Attorneys for Petitioner, John V. Dobson.

UNITED STATES BOARD OF TAX APPEALS, WASHINGTON

Docket No. 106553

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

v.

JOHN V. DOBSON, Respondent

Docket No. 106553

JOHN V. DOBSON, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

CERTIFICATE

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 76, inclusive, contain and are a true copy of the transcript of record,

papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 25th day of August 1942.

B. D. Gamble, Clerk, United States Board of Tax Appeals. (Seal.)

[fol. 81] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH DISTRICT

[Title omitted]

September 10, 1942.

ORDER CONSOLIDATING CASES FOR BRIEFING, HEARING, ARGUMENT AND DECISION AND AS TO PRINTING OF RECORDS

Come now the parties to the above entitled proceedings, by their counsel of record, and it is

[fol. 82] Ordered, that the above enttiled proceedings be consolidated for briefing, hearing, argument and decision; that one brief shall be filed on behalf of the Commissioner and one on behalf of the four taxpayers; that the first brief shall be filed by the Commissioner and that it shall be filed within forty days after the date on which the last transcript of record is filed with the Clerk of this Court in the cases in which the Commissioner has filed petitions for review; that the second brief shall be filed on behalf of the taxpayers twenty-five days after their receipt of the Commissioner's brief, in accordance with the rules of this Court; that in order to facilitate handling of these proceedings and also to provide a fair and practicable method of dividing costs, the transcripts of record in the three cases appealed by the Commissioner shall be consolidated for printing and be printed by the Commissioner when his brief is printed; that such record shall include, in the case of John V. Dobson, all the material needed to consider both of the issues referred to above with the exception of

the cross-petition for review which shall be printed as hereinafter indicated; that the transcript of record in H. J. Harwick v. Commissioner and the cross-petition in the case of John V. Dobson shall be printed together by the taxpayers therein with the cost of printing to be divided between them as they shall decide; and that the latter record shall be printed by the taxpayers in sufficient time for it to be available for use by counsel for Commissioner in preparation of his brief, or they shall furnish a copy of the record to be printed to counsel for Commissioner in ample time for his use.

September 10, 1942.

[fol. 83] Appearances of counsel omitted in printing

[fol. 84] IN UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT

[Title omitted]

ORDER OF SUBMISSION—January 6, 1943

[fol. 85] These causes, Nos. 12421, 12425, 12426, 12429 and 12430, having been called for hearing in their regular order, are argued together, and argument was commenced by Mr. John W. Windhorst for the Taxpayers, continued by Mr. S. Dee Hanson, Special Assistant to Attorney General, for Guy T. Helvering, Commissioner of Internal Revenue, and concluded by Mr. John W. Windhorst for the Taxpayers.

Thereupon, these causes were submitted to the Court on the abstract and transcripts of records and the briefs of counsel filed herein.

[fol. 86] In United States Circuit Court of Appeals, Eighth Circuit, March Term, A. D. 1943

No. 12,421

H. J. Harwick, Petitioner,

vs.

Commissioner of Internal Revenue, Respondent

No. 12,425

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner,

vs.

John V. Dobson, Respondent

No. 12,426

John V. Dobson, Petitioner,

vs.

Guy T. Helvering, Commissioner of Internal Revenue, Respondent

No. 12,429

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner,

vs.

Estate of James N. Collins, Deceased, First National Bank and Trust Company of Minneapolis, Executor, Respondent

No. 12,430

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner,

vs.

E. W. Dobson, Respondent

Petitions to Review Decisions of United States Board of Tax Appeals

[fol. 87] Mr. S. Dee Hanson, Special Assistant to the Attorney General (Mr. Samuel O. Clark, Jr., Assistant Attorney General, Mr. Sewall Key, Miss Helen R. Carloss and Miss Louise Foster, Special Assistants to the Attorney General, were on the brief), for the Commissioner of Internal Revenue.

Mr. John W. Windhorst (Mr. Leland W. Scott and Messrs. Fletcher, Dorsey, Barker, Colman & Barber were with him on the brief) for the Taxpayers.

Before Sanborn, Woodrough and Thomas, Circuit Judges

OPINION—March 2, 1943

THOMAS, Circuit Judge, delivered the opinion of the court.

These cases come here upon petitions to review decisions of the United States Board of Tax Appeals. By order of court they have been consolidated for briefing, hearing, argument and decision.

Several years before the taxable year 1939, the four taxpayers, all residents of the state of Minnesota, had at various times individually purchased, in transactions entered into for profit, shares of the capital stock of the National City Bank of New York, such stock carrying beneficial interests in the stock of the National City Company of New York. The purchases were made in the state of Minnesota from the National City Company. Each taxpayer sold a part or all of such stock at losses which were claimed and allowed as deductions on their income tax returns for 1930 and 1931.

On a sale of 200 shares E. W. Dobson in 1930 deducted a loss of $49,302.56 and his return showed a net loss of $30,197.56; John V. Dobson for sales in 1930 deducted $62,271 and showed in his return a net loss of $30,043.47; [fol. 88] James N. Collins deducted and was allowed $41,600.80 for 1930 and $28,163.78 for 1931 and his net loss for these years was $65,896.51 and $40,204.90, respectively; and H. J. Harwick was allowed a deduction in 1931 for a loss of $34,451.28, and he reported a net income of $12,042.03, but due to certain credits he owed no tax.

For several years the taxpayers regarded these purchases and sales as completed transactions. In 1936, 1937 and 1938 they learned for the first time that the stock had not been registered under the Blue Sky laws of Minnesota and that the sales to each of them may have ben fraudulent. Thereupon H. J. Harwick asserted a claim against the National City Company, and the other three taxpayers filed suits against the Company alleging (1) that the stock sold had not been registered as required by law and (2) that the sales had been fraudulent. They requested rescission of the sale contracts and offered to turn over to the Company the proceeds of the stock sales or an equal number of shares plus interest and dividends received.

Harwick's claim and the suits were all settled in 1939. In the settlement Harwick received a net amount of $17,000 and reported $9,884.22 as income, conceding that he had

received a tax benefit for that amount in 1931. He contended that the remaining $7,115.78 should not be taxed, because he could have added this amount to his 1931 gross income without tax liability resulting for the reason that credits to which he was entitled more than offset his net income. E. W. Dobson received $31,432.80; John V. Dobson $32,294.96; and James N. Collins $23,296.45, all of which recoveries were allocable to 1930 sales. Collins also received $6,454.18 allocable to a 1931 sale. Neither the Dobsons nor Collins reported any part of these sums as income in 1939, but the Commissioner included them all, as well as the $7,115.78 received by Harwick.

[fol. 89] Through the year 1939 adjustment of the taxpayers' income tax liability for the years deductions were claimed and allowed was barred by the statute of limitations.

The Board held that the recoveries in 1939 were in the nature of a capital recovery and were not subject to tax, unless the loss deductions of the prior years had actually offset gross income of those years and had thus resulted in a tax benefit. On this theory the Board held that E. W. Dobson and James N. Collins having realized no tax benefit from the loss deductions in 1930 and 1931, the sums recovered by them in 1939 were not taxable; that John V. Dobson having realized a tax benefit on $2,251.49, that sum was taxable in 1939 as ordinary income and was not capital gain; and that Harwick, having a net income in 1931, received a tax benefit on the entire recovery and that it should be included in his 1939 return.

The opinion of the Board in John V. Dobson's case is reported in 46 B. T. A. 770, and that of the Estate of James N. Collins in 46 B. T. A. 765. Opinions in the other cases are not officially reported.

The Commissioner contends that the recoveries of the taxpayers in 1939 relative to deductions claimed and allowed in 1930 and 1931 should all be included in their gross incomes for the year 1939 under § 22 of the Internal Revenue Code and taxed as ordinary income, and that the Board erred in refusing so to hold and in refusing to redetermine a deficiency in the case of E. W. Dobson in the amount of $7,490.86; in the case of John V. Dobson in the amount of $9,108.06; and in the case of the estate of James N. Collins in the amount of $2,644.58.

The taxpayers all contend that the Board correctly held that the taxability of the recoveries in 1939 depends on

whether the 1930 and 1931 deductions attributable to sales [fol. 90] of stock resulted in a tax benefit. Harwick and John V. Dobson in their appeals contend that the Board erred in holding that a tax benefit depends upon whether the losses produced a deficit in the taxpayers' net income for 1930 and 1931. They urge that a tax benefit depends on an actual saving in tax dollars for those years. All the taxpayers assert that to whatever extent taxable gain is found to exist by reason of the 1939 recoveries, such income is taxable as capital gain under § 117 of the Internal Revenue Code and not as ordinary income under § 22.

As a result of the Board's refusal to accept the contentions of the several taxpayers, Harwick contends that it erred in failing to order a refund to him in the amount of $2,914.84 on account of the inclusion in his 1939 return of gross income in the sum of $9,884.22 reported by him as ordinary income in that year, and in redetermining a deficiency of $4,629.01 for 1939. John V. Dobson contends that the Board erred in redetermining a deficiency in his income-tax liability for 1939 in the amount of $472.82 as a result of including $2,251.49 of his recovery in gross income for that year; and that, if such sum should be included, it should be taxed as capital gain and not as ordinary income.

A fact characteristic of all these cases is that the purchase price paid for the stock by each taxpayer was in excess of the proceeds received by him from the sale of the stock in 1930 and 1931 and the recovery from the National City Company in 1939 combined. As a whole the stock investment was a losing venture. The cases present only questions of law.

The first matter to be determined is the question of the validity of the tax benefit theory applied by the Board to [fol. 91] the taxability of the recovery in the taxable year of a capital loss sustained, and claimed and allowed as a deduction, in a prior year.

The conclusion of the Board and its reason therefor are stated in its opinion in the John V. Dobson case (46 B. T. A. 770) in the following language:

"Where there is recovery in respect of a loss sustained in an earlier year and a deduction of such loss claimed and allowed for the earlier year had effected an offset in taxable income, the amount recovered in the later year should be included in taxable income for the year of recovery, the

reason being that even though the subsequent recovery is in the nature of a capital recovery the prior deduction of the amount of the loss from taxable income has for income tax purposes already given the taxpayer a recoupment of said loss out of taxable income and the subsequent recovery, being in the nature of a replacement of taxable income, is equivalent to gain to the taxpayer. *National Bank of Commerce of Seattle* v. *Commissioner,* 115 F. 2d 875, affirming 40 B. T. A. 72. But where the deduction claimed and allowed in the prior year did not effect an offset of taxable income, the amount recovered in a later year does not constitute taxable income for the year of recovery."

The Board's explanation of its decision is not found in the Revenue Acts in effect in 1930, in 1931, or in 1939, nor in any of the regulations thereunder. The taxpayers, however, relying upon the decision of the Supreme Court in *Eisner* v. *Macomber,* 252 U. S. 189, 206, say that for constitutional reasons the tax cannot be sustained at all, unless it be upon the tax benefit theory. It is urged that there is no magic sufficient to convert capital into income for tax purposes. They argue that if there be such "magic" it is found in and limited in its application by some form of offset or recoupment.

[fol. 92] We are of the opinion that the constitutional question discussed in the Macomber case is not presented in these cases. Decision depends upon the application of well-settled principles of tax laws. The losses here were claimed and allowed pursuant to the privilege granted under § 23(e)(2) of the Revenue Act of 1928, c. 852, 45 Stat. 791, 26 U. S. C. A. Internal Revenue Acts. The pertinent part of the Act provides that in computing net income there shall be allowed as deductions, "In the case of individuals, losses sustained during the taxable year—* * * (2) if incurred in any transaction entered into for profit, though not connected with the trade or business."

The adoption of the tax benefit theory seems to be an injection into the law of an equitable principle, found neither in the statutes nor in the regulations, for the purpose apparently either of avoiding constitutional restrictions or of granting to the taxpayer relief in hard cases. In *Deputy* v. *du Pont,* 308 U. S. 488, 493, the Supreme Court said: "* * * allowance of deductions from gross income does not turn on general equitable considerations. It 'depends upon legislative grace.'" Citing *New Colon-*

ial Ice Co. v. *Helvering,* 292 U. S. 435, 440. See, also *Citizens National Bank* v. *Commissioner,* 8 Cir., 122 F. 2d 1011, 1013; *White* v. *United States,* 305 U. S. 281, 292; *Helvering* v. *Insurance Co.,* 294 U. S. 686, 689. It follows that when deductions for losses are taken, they can be taken on such conditions only as the government prescribes.

When the taxpayers here claimed and were allowed the deductions for losses on sales of stock in 1930 and 1931 under § 23(e) (2), supra, at least three conditions inhered in the allowance. First, any future adjustment or corrections were subject to the statute of limitations. Revenue Act of 1928, § 275(a). Second, Article 342 of Treasury Regulations 74, promulgated under the Revenue Act of [fol. 93] 1928, provided that "The expenses, liabilities or deficit of one year can not be used to reduce the income of a subsequent year." The regulation is consistent with the rule that the federal income tax system is based on an annual accounting. *Burnet* v. *Sanford & Brooks Co.,* 282 U. S. 359, 365; *Burnet* v. *Thompson Oil & Gas Co.,* 283 U. S. 301, 306; *Woolford Realty Co.* v. *Rose,* 286 U. S. 319, 326; *Brown* v. *Helvering,* 291 U. S. 193, 198-9; *Helvering* v. *Morgan's, Inc.,* 293 U. S. 121, 126-7; *Guaranty Trust Co.* v. *Commissioner,* 303 U. S. 493, 497-8; *Heiner* v. *Mellon,* 304 U. S. 271, 275. A third condition of the allowance of deductions for capital losses under the Revenue Act of 1928, as well as of the earlier and later Revenue Acts, is the requirement that such losses must be "realized" by some closed and completed "identifiable event" which definitely settles and determines the existence of and the amount of such losses. *Schoenberg* v. *Commissioner,* 8 Cir., 77 F. 2d 446, 448, and cases cited. See, also, *Higgins* v. *Smith,* 308 U. S. 473, 481.

The contention of the taxpayers requires these three conditions of the revenue laws to be evaded or ignored. The statute of limitations will be evaded by adjusting deductions in 1939 on the basis of equitable considerations resulting from events occurring in 1930 and 1931. Treasury Regulation 74 will be violated by using the deficits of one taxable year to reduce the income of a subsequent year; and a capital transaction represented by the taxpayer to be "closed and completed" in 1930 and 1931 must be reopened in 1939 in violation of all three of the conditions stated above. There is no escape under the law from the fact that the capital transactions of the taxpayers were

closed and their capital losses claimed and allowed in the years when the stocks were sold. The recoveries received in 1939 resulting from discovered fraud in the original [fol. 94] purchases were income in the year received. It is immaterial whether the claim was settled before suit, as in Harwick's case, or after suit was begun; and it is immaterial whether the taxpayer invoked as a remedy for fraud the right to rescission or the right to damages. In any case the recovery was income when received. Any diminution of gross income in 1939 because of lack of complete tax benefits from the deductions taken in 1930 and 1931 constitutes in reality a deduction in 1939 based upon equitable considerations and not upon the authority of an Act of Congress.

The circumstances in the case of *Griffiths* v. *Commissioner*, 308 U. S. 355, are so strikingly similar to the facts in this case that the decision illustrates the accepted view of the law, even though the tax benefit theory was not discussed. Griffiths, the taxpayer, paid one Lay $100,000 for some stock in 1926. The investment was unprofitable, and as the result of the sale of the stock to a family corporation Griffiths was allowed a deductible loss of $92,500 by the Commissioner for the year 1931. In 1933 Griffiths learned that he had been defrauded by Lay in the 1926 sale. Through a settlement with Lay in 1933 the stock, through a complicated series of transactions entered into to disguise the rescission of the original purchase, was transferred back to Lay and Griffiths personally received, from Lay $100,000. The Commissioner ruled that Griffiths, having been allowed a deduction for loss attributable to the stock purchased from Lay and having now recouped that loss through settlement of his claim against Lay, was subject to tax for the amount of the settlement in 1933. The Supreme Court held that "the Commissioner was right", and affirmed the decision of the Seventh Circuit Court of Appeals (103 F. 2d 110).

[fol. 95] Since the Board decided these cases the question of the application of the equitable doctrine involved in the tax benefit theory has been passed upon by the Third and Fourth Circuit Courts of Appeals in cases involving the recovery of bad debts and decided adversely to the theory of the Board and the contentions of the taxpayers. *Helvering* v. *State-Planters Bank & Trust Co., 4 Cir.*, 130 F. 2d 44; *Commissioner* v. *United States & International Securities*

Corporation, 3 Cir., 130 F. 2d 894. In the first of these cases Judge Parker, speaking for the court, observed that "There is nothing in the regulation or in any statute which makes the inclusion, in gross income of collections on bad debts, previously charged off as worthless, dependent upon whether or not the charge off has resulted in a tax benefit to the taxpayer." The court held that when the taxpayer charges off and is allowed a deduction for a bad debt in one year, he thereby under the existing regulations impliedly consents that a subsequent recovery shall be treated as income and not as a restoration of capital. In substance it was held that a taxpayer who obtains the allowance of a deduction for a bad debt, or capital loss, under a statute permitting such privilege, is bound by a regulation providing that any subsequent recovery of any part of such bad debt "must be included in gross income for the taxable year in which received."

These decisions are in agreement with *Stearns Coal & Lumber Co.* v. *Glenn, Collector*, D. C. Ky., 42 F. Supp. 28. The only case cited by the taxpayers reaching a contrary conclusion is that of *Philadelphia National Bank* v. *Rothensies*, D. C. Penn., 43 F. Supp. 923, in which it was held that the implied consent of the taxpayer, in the absence of express terms, cannot "be carried beyond the benefit received."

[fol. 96] We think the allowance of deductions from gross income cannot be made to depend upon general equitable considerations, such as are involved in the tax benefit theory; and that the taxpayers are barred by the conditions on which the government granted the deductions in the earlier years.

For the foregoing reasons we hold that the recoveries of the taxpayers in 1939, allocable to the sales of stock in 1930 and 1931, constitute taxable gain in the year received.

Harwick and John V. Dobson do not agree with the Board in the application of the tax benefit theory to their cases, but, since we hold that the tax benefit theory must be rejected entirely, it is unnecessary to discuss their contentions in this respect.

In view of our conclusion above there remains for consideration only the question whether the 1939 recoveries must be treated as ordinary income under § 22 or as long-term capital gains under § 117 of the Internal Revenue

Code.[1] Under the latter section only fifty per cent of the recoveries would be taxable.

[fol. 97] The question to be determined is whether the payments to the taxpayers by the National City Company in settlement of their claims constitute gain realized in a "sale or exchange" of a capital asset. It is not contended that an actual sale or exchange occurred in 1939 upon the settlement of the taxpayer's claims, but that the payments in 1939 take their character as capital gain from the sales of the stock in 1930 and 1931. This conclusion is arrived at in this way. It is said (1) that the taxpayers' claims against the National City Company were based on the right to rescind the stock purchase and to secure a refund of the purchase price; (2) that the Commissioner admits that where a taxpayer had not sold his stock the recovery in 1939 attributable to such unsold stock was not taxable; and (3) that, therefore, the receipt of income in 1939 (to whatever extent taxable) represented "gain from the sale" of the stock in 1931 which was not taxable until received in 1939.

The contention lacks merit. The Commissioner did not admit that deductions which had been claimed and allowed as a result of sales in 1930 and 1931 could be converted into non-taxable recoveries in 1939. There was no causal relation between the sales in the former years and the recoveries in the latter. The sales of stock and the settle-

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[1] Section 22 of the Internal Revenue Code, 26 U. S. C. A. 22, provides:

"Gross income" includes gains, profits, and income derived from * * * trades, business, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

Section 117 (a) provides:

(4) *Long-term capital gain.* The term "long-term capital gain" means gains from the sale or exchange of a capital asset held for more than 18 months, if and to the extent such gain is taken into account in computing net income;

(5) *Long-term capital loss.* The term "long-term capital loss" means loss from the sale or exchange of a capital asset held for more than 18 months, if and to the extent such loss is taken into account in computing net income.

ments of the claims were different and distinct transactions. The settlements considered separately were neither sales nor exchanges within the meaning of the statute. *Lee* v. *Commissioner*, 7 Cir., 119 F. 2d 946; *Bingham* v. *Commissioner*, 2 Cir., 105 F. 2d 971; *Hale* v. *Helvering*, App. D. C., 85 F. 2d 819. The taxpayers sold nothing in 1939 to the National City Company and the National City Company purchased nothing from the taxpayers. Neither was there an exchange, for "exchange", as used in the statute, means reciprocal transfers of capital assets. [fol. 98] *Helvering* v. *Flaccus Leather Co.*, 313 U. S. 247, 249. The sales of stock were completed transactions in 1930 and 1931, and they can neither in fact nor in law be coupled with the settlements in 1939 so as to transform the two events into a single sale or exchange of capital assets. The Board was right in holding that the recoveries in 1939 were taxable as ordinary income and not as long-term capital gains.

The decision of the Board in No. 12,421, Harwick v. Commissioner, is affirmed.

In No. 12,430, Helvering v. E. W. Dobson, and in No. 12,429, Helvering v. Estate of James N. Collins, the decisions are reversed and the cases remanded with instructions to tax as ordinary income the entire recoveries attributable to the losses claimed and allowed in previous years.

In the John V. Dobson cases, Nos. 12,425 and 12,426, the decision is reversed and the cases remanded with instructions to tax as ordinary income the entire amount recovered in 1939 attributable to the loss claimed and allowed in 1930.

[fol. 99] IN UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT, MARCH TERM, 1943

No. 12421

H. J. HARWICK, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE

On Petition to Review Decision of United States Board of Tax Appeals

JUDGMENT—March 2, 1943

This cause came on to be heard on the petition to review the decision of the United States Board of Tax Appeals

entered April 23, 1942, deciding that there is a deficiency in income tax of the Taxpayer for the year 1939, and was argued by counsel.

On Consideration Whereof, It is now here Ordered and Adjudged by this Court that the decision of the said Board of Tax Appeals in this cause be, and the same is hereby, affirmed.

And it is further Ordered by this Court that the petition to review herein be, and the same is hereby, dismissed without the taxation of costs in this Court in favor of either of the parties.

March 2, 1943.

[fol. 100] IN UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT, MARCH TERM, 1943

No. 12425

GUY T. HELVERING, Commissioner of Internal Revenue, Petitioner,

vs.

JOHN V. DOBSON

No. 12426

JOHN V. DOBSON, Petitioner,

vs.

GUY T. HELVERING, Commissioner of Internal Revenue

JUDGMENT—March 2, 1943

On Petitions to Review Decision of the United States Board of Tax Appeals

These causes came on to be heard on the petitions filed by Guy T. Helvering, Commissioner of Internal Revenue, and by John V. Dobson to review the decision of the United States Board of Tax Appeals entered April 22, 1942, deciding that there is a deficiency in income tax of the Taxpayer for the year 1939, and were argued by counsel.

On Consideration Whereof, It is now here Ordered and Adjudged by this Court that the decision of the said Board of Tax Appeals in these causes be, and the same is hereby, reversed without taxation of costs in favor of either of the parties in this Court.

And it is further Ordered by this Court that these causes be, and they are hereby, remanded to The Tax Court of the United States as the successor of the United States Board [fol. 101] of Tax Appeals with instructions to tax as ordinary income the entire amount recovered in the year 1939 attributable to the loss claimed and allowed in the year 1930.

March 2, 1943.

[fol. 102] In United States Circuit Court of Appeals, Eighth Circuit, March Term, 1943

No. 12429

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner,

vs.

Estate of James N. Collins, Deceased, First National Bank and Trust Company of Minneapolis, Executor

Judgment—March 2, 1943

On Petition to Review Decision of United States Board of Tax Appeals

This cause came on to be heard on the petition to review the decision of the United States Board of Tax Appeals entered April 25, 1942, deciding that there is no deficiency in income tax of the Taxpayer for the year 1939, and was argued by counsel.

On Consideration Whereof, It is now here Ordered and Adjudged by this Court that the decision of the said Board of Tax Appeals in this cause be, and the same is hereby, reversed without taxation of costs in favor of either of the parties in this Court.

And it is further Ordered by this Court that this cause be, and it is hereby, remanded to The Tax Court of the United States as the successor of the United States Board of Tax Appeals with instructions to tax as ordinary income the entire recoveries attributable to the losses claimed and allowed in previous years.

March 2, 1943.

[fol. 103] IN UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT

No. 12430—March Term, 1943

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, Petitioner,

vs.

E. W. DOBSON

ON PETITION TO REVIEW DECISION OF UNITED STATES BOARD OF TAX APPEALS

JUDGMENT—March 2, 1943

This cause came on to be heard on the petition to review the decision of the United States Board of Tax Appeals entered March 30, 1942, deciding that there is no deficiency in income tax of the Taxpayer for the year 1939, and was argued by counsel.

On Consideration Whereof, It is now here Ordered and Adjudged by this Court that the decision of the said Board of Tax Appeals in this cause be, and the same is hereby, reversed without taxation of costs in favor of either of the parties in this Court.

And it is further Ordered by this Court that this cause be, and it is hereby, remanded to The Tax Court of the United States as the successor of the United States Board of Tax Appeals with instructions to tax as ordinary income the entire recoveries attributable to the losses claimed and allowed in previous years.

March 2, 1943.

[fol. 104] IN UNITED STATES CIRCUIT COURT OF APPEALS

MOTION OF TAXPAYERS FOR STAY OF MANDATES—Filed March 18, 1943

Now come the above named taxpayers, by John W. Windhorst, their attorney, and respectfully move this Honorable Court to stay and withhold its mandate in the above entitled actions for the purpose of permitting said taxpayers to file with the Clerk of the Supreme Court of the United

States their petitions for writs of certiorari in said causes until and including the 16th day of April, 1943, and to order that the stay of said mandates be continued if, on or before said date, said petitions are filed and the Clerk of this court receives from the Clerk of the Supreme Court his certificates of said filing until the final disposition of said causes by the Supreme Court of the United States, all as provided by Rule 16 of this Court.

Dated March 17, 1943.

John W. Windhorst, Attorney for Taxpayers, 1300 First National-Soo Line Bldg., Minneapolis, Minnesota.

Leland W. Scott and Dorsey, Colman, Barker, Scott & Barber, of Counsel.

[File endorsement omitted.]

[fol. 105] ORDER STAYING ISSUANCE OF MANDATES

Memorandum of Clerk of U. S. Circuit Court of Appeals for the Eighth Circuit:

Orders were entered in the within cases staying issuance of mandates on motion of taxpayers and all orders are alike except that they are either on motion of petitioner, taxpayer or respondent. With this exception each order is in the following words:

March Term, 1943.
Saturday, March 20, 1943.

On Consideration of the motion of the petitioner for a stay of the mandate in this cause pending a petition to the Supreme Court of the United States for a writ of certiorari, It is now here ordered by this Court that the issuance of the mandate herein be, and the same is hereby, stayed for a period of thirty days from and after this date, and if within said period of thirty days there is filed with the Clerk of this Court a certificate of the Clerk of the Supreme Court of the United States that a petition for writ of certiorari, record and brief have been filed, the stay hereby granted shall continue until the final disposition of the case by the Supreme Court.

March 20, 1943.

[fols. 106-107] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 108] SUPREME COURT OF THE UNITED STATES

No. 44—October Term, 1943

ORDER ALLOWING CERTIORARI—Filed June 14, 1943

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Eighth Circuit is granted, and the case is transferred to the summary docket.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[fol. 109] SUPREME COURT OF THE UNITED STATES

No. 45—October Term, 1943

ORDER ALLOWING CERTIORARI—Filed June 14, 1943

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Eighth Circuit is granted, and the case is transferred to the summary docket.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[fol. 110] SUPREME COURT OF THE UNITED STATES

No. 46—October Term, 1943

ORDER ALLOWING CERTIORARI—Filed June 14, 1943

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Eighth Circuit is granted, and the case is transferred to the summary docket.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[fol. 111] SUPREME COURT OF THE UNITED STATES

No. 47—October Term, 1943

ORDER ALLOWING CERTIORARI—Filed June 14, 1943

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Eighth Circuit is granted, and the case is transferred to the summary docket.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[Endorsed on Cover:] File No. 47,431, 47,432, 47,433, 47,434, U. S. Circuit Court of Appeals, Eighth Circuit. Term No. 44, John V. Dobson, Petitioner, vs. Guy T. Helvering, Commissioner of Internal Revenue. Term No. 45, E. W. Dobson, Petitioner, vs. Guy T. Helvering, Commissioner of Internal Revenue. Term No. 46, Estate of James N. Collins, Deceased, First National Bank and Trust Company of Minneapolis, Executor, Petitioner vs. Guy T. Helvering, Commissioner of Internal Revenue. Term No. 47, H. J. Harwick, Petitioner, vs. Commissioner of Internal Revenue. Petition for writs or certiorari and exhibit thereto. Filed April 15, 1943. Term No. 44 O. T. 1943, 45 O. T. 1943, 46 O. T. 1943, 47 O. T. 1943.

FILE COPY

IN THE

Supreme Court of the United States

No. ~~933~~ 44-47

JOHN V. DOBSON,
Petitioner,
vs.
GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Respondent.

~~JOHN V. DOBSON,~~
~~Petitioner,~~
~~vs.~~
~~GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,~~
~~Respondent.~~

E. W. DOBSON,
Petitioner,
vs.
GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ESTATE OF JAMES N. COLLINS, DECEASED, FIRST NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, EXECUTOR,
Petitioner,
vs.
GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Respondent.

H. J. HARWICK,
Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT AND BRIEF IN SUPPORT THEREOF

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Minneapolis, Minnesota.

Of Counsel:
JOHN W. WINDHORST AND
DORSEY, COLMAN, BARKER, SCOTT & BARBER.

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1. The Circuit Court of Appeals in deciding that the recoveries realized by the taxpayers in 1939 as the result of a rescission of previous stock purchases constitute income has decided that recoveries of capital may be taxed under the federal income tax law and thus it has decided a question of federal income tax law in a way which is in conflict with applicable decisions of this court	14
2. The Circuit Court of Appeals in deciding that the sales of stock in years prior to 1939 were sufficient to sustain the conclusion that recoveries of the original purchase price in 1939 constituted income, even though the losses sustained as a result of the sales in such prior years did not offset or reduce taxable income for said years, has decided a question of federal income tax law in a way which is in conflict with the decisions of other Circuit Courts of Appeal on the same matter	21
3. If the decision of the Circuit Court of Appeals is not in conflict with the applicable decisions of this court (as alleged at 1 above), then the Circuit Court of Appeals in deciding that the recoveries realized by the taxpayers in 1939 as the result of a rescission of previous stock purchases constitute income has decided that recoveries of capital may be taxed under federal income tax law and thus it has decided an important question of federal income tax law which has not been, but should be, settled by this court	24
4. The Circuit Court of Appeals in deciding that the recoveries realized by the taxpayers in 1939 as the result of a rescission of previous stock purchases constitute income which is taxable as ordinary income rather than as capital gain under Sec. 117 of the Internal Revenue Code has decided an important question of federal income tax law which has not been, but should be, settled by this court	25
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IN THE

Supreme Court of the United States

No. .....

JOHN V. DOBSON,

Petitioner,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Respondent.

~~JOHN V. DOBSON,~~

~~*Petitioner,*~~

~~*vs.*~~

~~GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,~~

~~*Respondent.*~~

E. W. DOBSON,

Petitioner,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ESTATE OF JAMES N. COLLINS, DECEASED, FIRST NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, EXECUTOR,

Petitioner,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Respondent.

H. J. HARWICK,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT AND BRIEF IN SUPPORT THEREOF

To the Honorable Harlan F. Stone, Chief Justice of the United States, and the Associate Justices of the Supreme Court of the United States:

John V. Dobson, E. W. Dobson, First National Bank and Trust Company of Minneapolis, as Executor of the estate of James N. Collins, deceased, and H. J. Harwick, respectively pray for writs of certiorari to review the judgments of the Circuit Court of Appeals of the Eighth Circuit entered on March 2, 1943 (C. C. A., R. 15-17), respectively affirming the decision of the United States Board of Tax Appeals in the case of *H. J. Harwick vs. Commissioner of Internal Revenue*, No. 12421 (Harwick, R. 10), reversing the decision of the Board in the case of *Guy T. Helvering, Commissioner of Internal Revenue, vs. E. W. Dobson*, No. 12420 (R. 40), and in the case of *Guy T. Helvering, Commissioner of Internal Revenue, vs. Estate of James N. Collins, Deceased, First National Bank and Trust Company of Minneapolis, Executor*, No. 12429 (R. 15), and remanding said cases with instructions to tax as ordinary income the entire recoveries attributable to the purchase price of stock which had been sold in prior years at losses which had been claimed and allowed, and reversing the decision of the Board in the case of *John V. Dobson vs. Guy T. Helvering, Commissioner of Internal Revenue*, No. 12426, and in the case of *Guy T. Helvering, Commissioner of Internal Revenue, vs. John V. Dobson*, No. 12425 (R. 62), and remanding said cases with instructions to tax as ordinary income the entire amount recovered in 1939 attributable to the purchase price of stock

which had been sold in 1930 and the loss thereon claimed and allowed in said year.[1]

STATEMENT OF THE MATTERS INVOLVED

These cases involve the legality under the Internal Revenue Code and the United States Constitution of treating as taxable income amounts recovered on an investment (through refund of part of the purchase price) under circumstances which establish conclusively that the taxpayer had not realized and would not realize any *gain* from such investment. The investment here involved consisted of corporate stock which had been sold at a loss by the purchasers prior to the year of recovery.[2] Subsequently an action for rescission of the original purchase price was settled by a return of a part only of the original purchase price. The amount of the recovery was less than the loss sustained upon the sale by the purchasers and said loss, although referred to in the taxpayers' income tax return for the year in which the sale occurred, did not offset any taxable income for the reason that said return already showed a net loss without using this particular deduction.[2]

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[1]Because all of the above cases were consolidated before the Circuit Court of Appeals for the Eighth Circuit for the purpose of the preparation of the record and briefs and for the purpose of argument and decision, a single petition for writs of certiorari is filed. The consolidated record with respect to these cases contains four parts, viz.: (1) the principal record which includes all of the records in these cases before the Circuit Court of Appeals except (2) the record in the H. J. Harwick case, No. 12421, (3) the partial record in the John V. Dobson case, No. 12426, containing the petition of John V. Dobson for review of the decision of the United States Board of Tax Appeals, notice of filing, and acknowledgment of service of the same and certificate of the clerk to the transcript, and (4) additional proceedings in the Circuit Court of Appeals. Reference herein to the principal record is in the form of (R. 5), reference to the record in the H. J. Harwick case is in the form of (Harwick, R. 5), reference to the partial record in the John V. Dobson case is in the form of (Dobson, R. 5), and reference to the additional proceedings in the Circuit Court of Appeals is in the form of (C. C. A., R. 5).

[2]Slight variations in these facts exist in the J. V. Dobson and Harwick cases. The Circuit Court of Appeals for the Eighth Circuit in view of its decision in the other cases did not find it necessary to pass on the materiality of these variations.

PROVISIONS OF THE CONSTITUTION OF THE UNITED STATES AND STATUTES INVOLVED

Amendments to the Constitution of the United States, Article XVI:

> "The Congress shall have power to lay and collect taxes on income from whatever source derived without apportionment among the several states and without regard to any census or enumeration."

Sec. 22 (a), *Internal Revenue Code*, 53 Stat. 9; 574; 575:

> "(a) General Definition.—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a state, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. In the case of Presidents of the United States and judges of courts of the United States taking office after June 6, 1932, the compensation received as such shall be included in gross income; and all Acts fixing the compensation of such Presidents and judges are hereby amended accordingly. In the case of judges of courts of the United States who took office on or before June 6, 1932, the compensation received as such shall be included in gross income."

STATEMENT OF FACTS

The stipulated facts (R. 21-25, 44-47, 74-79, Harwick, R. 20-30) in each of the above cases, which have been consolidated for briefing, argument, and decision in the Circuit Court of Appeals and for the preparation of this petition, were adopted by the United States Board of Tax Appeals as its Findings of Fact (R. 15-17, 40-42, 63-64, Harwick, R. 10-13). Because neither party has distinguished between the facts involved in any of these cases in so far as the *general principle* involved in this petition is concerned and in the interests of clarity and brevity we will hereinafter set forth only the facts involved in *Estate of James N. Collins, Deceased, First National Bank and Trust Company of Minneapolis, Executor, vs. Guy T. Helvering, Commissioner of Internal Revenue.*

Several years before the taxable year 1939 the four taxpayers here, all residents of Minnesota, had made individual purchases in that State from National City Company of the stock of National City Bank of New York, and each had sold a portion or all of such stock at losses, which, except as hereinafter noted, were deducted on their income tax returns (R. 16, 40, 63, Harwick, R. 10).

James N. Collins[3] sold 100 shares of this stock in 1930, which had cost $56,200, for $14,599.20 and thereby sustained a deductible loss of $41,600.80, which the taxpayer referred to in his 1930 Federal income tax return and the deductibility of which was not questioned by the Commissioner upon audit of the return.

Collins also sold 100 shares in 1931, which had cost $37,100, for $8,936.22 and sustained a loss of $28,163.78, which was referred to on his 1931 return and allowed by

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[3]Collins died on April 21, 1941, which was before his case was heard by the Board, and his executor was substituted as the petitioner, but for convenience Collins will be referred to here as the taxpayer (R. 15).

the Commissioner. Including these losses, the net loss disclosed in his income tax return for 1930 was $65,896.51, and for 1931, $40,204.90 (R. 16, 24). In addition to this stock Collins owned 100 shares of stock acquired at a cost of $30,000, which he continued to hold throughout the year 1939 (R. 16, 22).

Several years after the above sales Collins and the other taxpayers learned that grounds for rescinding these purchases existed. Accordingly, Collins filed suit against National City Company, as did each of the other taxpayers except Harwick, who merely asserted a claim against that company, each contending:

1. That the stock had been sold to them without having been registered, as required by state law, and

2. That the sales had been fraudulent.

The complaint in each suit embodied a request for a rescission of the sales contracts and also an offer to turn over the proceeds of the stock sales or an equal number of shares, plus income thereon (R. 16, 41, 64).

These suits, as well as Harwick's claim, were settled in 1939 by the company making payment to each of the taxpayers. Upon receipt of these payments the suits were dismissed with prejudice pursuant to a stipulation of the parties (R. 16, 41, 64). Harwick also executed an instrument releasing the National City Company from all claims which he had against it (Harwick, R. 11, 24).

As a result of this settlement James N. Collins received a net amount of $45,150.63, of which $23,296.45 was allocable to the stock sold in 1930 and $6,454.18 was allocable to the stock sold in 1931. The balance of the recovery was allocable to the stock which Collins still owned (R. 23). Collins did not report any of the recovery as income in 1939,

but the first two amounts allocable to the stock sold in 1930 and 1931, viz.: $29,750.63, were held by the Commissioner to be taxable income (R. 16-17).

Throughout the year 1939 adjustment of these taxpayers' income tax liability for 1930 and 1931 was barred by the Statute of Limitations (R. 17, 42, 65, Harwick, R. 13).

As to these recoveries in 1939, the Board held in effect that such payments constituted a return of capital and were not subject to tax unless the loss deductions of the prior years had actually offset gross income of those years and so had resulted in a tax benefit.

In applying this test the Board held as to James N. Collins that (1) since the amount received upon sale of the stock in 1930 and 1931, plus the amount recovered, was less than the original purchase price of the stock, viz.:

	1930		*1931*
Cost of stock	$56,200.00		$37,100.00
Sale price..$14,599.20		$8,936.22	
1939 Recovery 23,296.45		6,454.18	
Total Recovery	37,895.65		15,390.40
Net loss from transaction ...	$18,304.35		$21,709.60

(2) and since the losses referred to in the taxpayer's 1930 and 1931 tax returns did not offset any income, viz.:

	1930	*1931*
Net *losses* per return...	$65,896.51	$40,204.90
Eliminate entire loss on sale of National City Bank stock	41,600.80	28,163.78
Adjusted net *loss*.....	$24,295.71	$12,041.12

the taxpayer had not recovered or recouped his capital investment in this stock and therefore was not taxable on the sum recovered in 1939 allocable to the stock sold in 1930 and 1931 (R. 18-20).

From these decisions of the Board the Commissioner appealed in the cases involving the tax liability of E. W. Dobson, James N. Collins, and John V. Dobson. The taxpayer H. J. Harwick appealed and John V. Dobson took a cross-appeal from the portion of the decision of the Board dealing with the application of the principle referred to above to their particular facts, and from the portion of the decision of the Board holding that to the extent that taxable income resulted from the recoveries such income was taxable as ordinary income rather than as capital gain under Section 117 of the *Internal Revenue Code*. The cases were consolidated before the Circuit Court of Appeals for the Eighth Circuit and on March 2, 1943, that court entered the following decision (C. C. A., R. 14):

As to the appeals taken by the Commissioner, the court reversed the decision of the Board and held that the entire amounts recovered by the taxpayers in 1939 from National City Company constituted taxable income for the reason that according to the court (C. C. A., R. 10) the recoveries were "income when received" and, constituting income, could not be reduced by losses sustained in a year prior to 1939. The court therefore refused to pass on the first issue raised in the appeals by Harwick and John V. Dobson, and as to the second issue raised by them the court affirmed the decision of the Board and held that the entire amount recovered was taxable as ordinary income and not as capital gain.

REASONS FOR ALLOWANCE OF WRITS OF CERTIORARI

1. The Circuit Court of Appeals in deciding that the recoveries realized by the taxpayers in 1939 as the result of a rescission of previous stock purchases constitute income has decided that recoveries of capital may be taxed under the Federal income tax law and thus it has decided a question of Federal income tax law in a way which is in conflict with applicable decisions of this court.

2. The Circuit Court of Appeals in deciding that the sales of stock in years prior to 1939 were sufficient to sustain the conclusion that recoveries of the original purchase price in 1939 constituted income, even though the losses sustained as a result of the sales in such prior years did not offset or reduce taxable income for said years, has decided a question of Federal income tax law in a way which is in conflict with the decisions of other Circuit Courts of Appeal on the same matter.

3. If the decision of the Circuit Court of Appeals is not in conflict with the applicable decisions of this court (as alleged at 1 above), then the Circuit Court of Appeals in deciding that the recoveries realized by the taxpayers in 1939 as the result of a rescission of previous stock purchases constitute income has decided that recoveries of capital may be taxed under Federal income tax law and thus it has decided an important question of Federal income tax law which has not been, but should be, settled by this court.

4. The Circuit Court of Appeals in deciding that the recoveries realized by the taxpayers in 1939 as the result of a rescission of previous stock purchases constitute income which is taxable as ordinary income rather than as capital gain under Section 117 of the Internal Revenue Code has

decided an important question of Federal income tax law which has not been, but should be, settled by this court.

Wherefore, Your petitioners respectfully pray that writs of certiorari issue to the United States Circuit Court of Appeals for the Eighth Circuit and submit their brief hereto attached in support of this petition.

Respectfully submitted,

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IN THE

SUPREME COURT OF THE UNITED STATES

No. .....

JOHN V. DOBSON,

Petitioner,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Respondent.

~~JOHN V. DOBSON,~~

~~*Petitioner,*~~

~~*vs.*~~

~~GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,~~

~~*Respondent.*~~

E. W. DOBSON,

Petitioner,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ESTATE OF JAMES N. COLLINS, DECEASED, FIRST NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, EXECUTOR,

Petitioner,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Respondent.

H. J. HARWICK,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRITS OF CERTIORARI

OPINIONS BELOW

The opinion of the Circuit Court of Appeals for the Eighth Circuit rendered March 2, 1943, ... Fed. (2d) ..., is found at C. C. A., R. 3. The opinions of the United States Board of Tax Appeals are found:

Estate of James N. Collins (R. 15),
E. W. Dobson (R. 40),
John V. Dobson (R. 62),
H. J. Harwick (Harwick, R. 10).

JURISDICTION

This petition is made under Sec. 240 of the *Judicial Code*, as amended, by the Act of February 13, 1925, 43 Stat. 938. The date of the judgments asked to be reviewed is March 2, 1943.

SUMMARY OF ARGUMENT

1. The Circuit Court of Appeals in deciding that the recoveries realized by the taxpayers in 1939 as the result of a rescission of previous stock purchases constitute income has decided that recoveries of capital may be taxed under the Federal income tax law and thus it has decided a question of Federal income tax law in a way which is in conflict with applicable decisions of this court.

2. The Circuit Court of Appeals in deciding that the sales of stock in years prior to 1939 were sufficient to sustain the conclusion that recoveries of the original purchase

price in 1939 constituted income, even though the losses sustained as a result of the sales in such prior years did not offset or reduce taxable income for said years, has decided a question of Federal income tax law in a way which is in conflict with the decisions of other Circuit Courts of Appeal on the same matter.

3. If the decision of the Circuit Court of Appeals is not in conflict with the applicable decisions of this court (as alleged at 1 above), then the Circuit Court of Appeals in deciding that the recoveries realized by the taxpayers in 1939 as the result of a rescission of previous stock purchases constitute income has decided that recoveries of capital may be taxed under Federal income tax law and thus it has decided an important question of Federal income tax law which has not been, but should be, settled by this court.

4. The Circuit Court of Appeals in deciding that the recoveries realized by the taxpayers in 1939 as the result of a rescission of previous stock purchases constitute income which is taxable as ordinary income rather than as capital gain under Sec. 117 of the *Internal Revenue Code* has decided an important question of Federal income tax law which has not been, but should be, settled by this court.

ARGUMENT

1. The Circuit Court of Appeals in Deciding That the Recoveries Realized by the Taxpayers in 1939 as the Result of a Rescission of Previous Stock Purchases Constitute Income Has Decided That Recoveries of Capital May Be Taxed Under the Federal Income Tax Law and Thus it Has Decided a Question of Federal Income Tax Law in a Way Which Is in Conflict With Applicable Decisions of This Court.

The Circuit Court of Appeals concluded (C. C. A., R. 10) that the recoveries from National City Company here involved were income when received. The court cited *no authority* for this proposition and the petitioners assert that it is contrary to the facts and law applicable to the recoveries.

The facts are clear. It has been stipulated (R. 22, 45, 76, Harwick, R. 21) that the taxpayers' claims arose out of the discovery in 1936, 1937, or 1938 of facts which led each of them to believe that the National City Bank of New York stock purchased by them had not been registered in accordance with the requirements of the Minnesota Blue Sky Laws and that said sales had been fraudulent. In addition to this stipulation the factual basis for the contention that the recoveries from National City Company did not constitute income is most clearly illustrated by the facts involved in the James N. Collins case. Collins acquired his stock in 1929 and sold it in 1930 and 1931 at a substantial loss. Had Collins not claimed *any* loss as a result of such sales in his 1930 and 1931 returns, such returns, nevertheless, would have disclosed losses of $24,295.80 and $12,041.12, respectively (R. 23, 24). Furthermore, the sum of the sales price of the stock in 1930 and 1931, plus the amounts recovered in 1939, was less than the original cost

of the stock to Collins (R. 16, 21-23). The importance of these facts with respect to the effect of the sales upon Collins' 1930 and 1931 tax liability is that they negative any conclusion that Collins is estopped to assert or can be said to have waived his right to claim that the recovery in 1939 constituted a capital recovery.

The applicable law as to the nature of the recovery is equally clear. The Minnesota Supreme Court has held upon numerous occasions that claims such as here involved are based upon a rescission of the contract of sale and a recovery of the purchase price.

Babcock vs. Bancamerica-Blair Corporation (1942), 212 Minn. 428, 4 N. W. (2d) 89;

Vercellini vs. U. S. I. Realty Co. (1924), 158 Minn. 72, 196 N. W. 672;

E. E. Webster vs. U. S. I. Realty Co. (1927), 170 Minn. 360, 212 N. W. 806;

Drees vs. Minnesota Petroleum Co. (1933), 189 Minn. 608, 250 N. W. 563;

Edson vs. O'Connell (1934), 190 Minn. 444, 252 N. W. 217;

See, also, *Vogel vs. Chase Securities Corporation* (1936), 19 Fed. Supp. 564.

The Board of Tax Appeals also characterized these recoveries as resulting from a rescission of the original sale (R. 17).

The Circuit Court of Appeals stated that the above facts and authorities were immaterial, and without citation of any authority or further explanation, other than the statement that the capital transaction was closed when the stock was sold, the court concluded that the recoveries were income when received. The Circuit Court of Appeals then proceeded to demonstrate, with ample citation of authority, that

losses and deficits for prior years could not be used to offset or reduce income for the current year. The petitioners submit that the basic and erroneous premise in the conclusion of the Circuit Court of Appeals is the proposition that these recoveries were income when received and that this premise has no support in the facts or the authorities. This premise upon which the decision of the Circuit Court of Appeals is based is contrary to decisions of this court in numerous cases.

In the case of *Bowers vs. Kerbaugh-Empire Co.* (1926), 271 U. S. 170, 46 Sup. Ct. 449, 70 L. Ed. 886, the taxpayer had borrowed money under a contract requiring repayment in German marks. After the declaration of war upon Germany the unpaid balance on this loan was paid off in German marks which at that time had greatly depreciated in value. As a result the difference between the United States dollars, into which proceeds of the original loan had been converted, and the United States dollars necessary to purchase the depreciated marks with which to pay off the loan was $684,456.18. The money when borrowed had been used in construction projects by the taxpayer and its subsidiary but these projects had resulted in substantial net losses prior to the year in which the debt was paid. The court, page 172, pointed out that the losses sustained in such prior years were in excess of the asserted income, viz.: $684,456.18, and stated that these were among the "essential facts" which supported the conclusion that this transaction did not result in income. The court further stated, page 174, that "In determining what constitutes income, substance rather than form is to be given controlling weight," and concluded, page 175, that "The mere diminution of loss is not gain, profit, or income."

The importance of the fact in the *Kerbaugh-Empire Co.* case, *supra,* that the transactions in prior years had result-

ed in net losses and the recognition of this court that whether or not such losses existed would determine the taxable character of subsequent capital transactions is demonstrated by later citations of that case by this court. *United States vs. Kirby Lumber Co.* (1931), 284 U. S. 1, 3, 52 Sup. Ct. 4, 76 L. Ed. 131; *Helvering vs. American Chicle Co.* (1934), 291 U. S. 426, 430, 54 Sup. Ct. 460, 78 L. Ed. 891.

The definition of income approved by the court in the *Kerbaugh-Empire Co.* case was based on previous decisions in which this court had held that a recovery of capital on an asset *held by the taxpayer at the time of the recovery* does not constitute income under the Sixteenth Amendment. See *Miles vs. Safe Deposit & Trust Co.* (1922), 259 U. S. 247, 42 Sup. Ct. 483, 66 L. Ed. 923; *Towne vs. Eisner* (1918), 245 U. S. 418, 38 Sup. Ct. 158, 62 L. Ed. 372; and *Eisner vs. Macomber* (1920), 252 U. S. 189, 206, *et seq.*, 40 Sup. Ct. 189, 64 L. Ed. 521, where this court said:

> "For the present purpose we recognize only a clear definition of the term 'income' as used in common speech in order to determine its meaning in the amendment * * *. Income may be defined as the gain derived from capital, from labor, or from both combined, provided it be understood to include profit through a sale or conversion of capital assets * * *."

The definition of income quoted above also was approved by this court in *Goodrich vs. Edwards* (1920), 255 U. S. 527, 41 Sup. Ct. 390, 65 L. Ed. 758. That case involved Sec. 2 (c) of the *Revenue Act of 1916*, 39 Stat. 758, which provided that "For the purpose of ascertaining the gain derived from a sale or other disposition of property, real, personal, or mixed, acquired before March 1, 1913, the fair market price or value of such property as of March 1, 1913, shall be the basis for determining the amount of such gain derived." The Commissioner had ruled that under this

statute the March 1, 1913, value was to be used in determining gain, even though that value was less than the cost to the taxpayer. The court rejected this contention, emphasizing that the *Revenue Act of 1916* (similar in this respect to the Revenue Acts here involved) imposed no tax except where *gains* were realized. Although the Solicitor General confessed error in the Goodrich case, the court later reaffirmed its conclusions and stated that its decision was not based on this confession of error. *United States vs. Flannery* (1925), 268 U. S. 98, 103, 45 Sup. Ct. 420, 69 L. Ed. 865.

In the case of *Burnet vs. Sanford & Brooks Co.* (1931), 282 U. S. 359, 51 Sup. Ct. 150, 75 L. Ed. 383, the taxpayer performed a contract for the United States Government which resulted in the realization of losses by the taxpayer while the contracts were being performed during the years 1913 to 1916. Subsequent to the abandonment of the work the taxpayer sued the United States and recovered additional compensation under the contract. This recovery was received by the taxpayer in 1920 and this court sustained the Commissioner in including the recovery in taxpayer's income for 1920, despite the fact that because of losses sustained on the Government work in 1913 to 1916, the taxpayer's income tax return had shown large net losses for all years except 1914. The basis for the decision was the conclusion that the recovery in 1920 constituted gross income for that year and that there was no statutory authority for disregarding the annual accounting periods so as to permit the bringing forward of losses sustained in prior years. It is apparent that the essential premise for the court's conclusion is the finding that the money which was received was an income as distinguished from a non-income item such as a return of capital or refund of previous expenditures. This court expressly recognized the prin-

ciple upon which we are here relying. The court said:

> "That the recovery made by respondent in 1920 was gross income for that year within the meaning of these sections cannot, we think, be doubted. The money received was derived from a contract entered into in the course of respondent's business operations for profit. While it equalled, and in a loose sense was a return of, expenditures made in performing the contract, still, as the Board of Tax Appeals found, the expenditures were made in defraying the expenses incurred in the prosecution of the work under the contract, for the purpose of earning profits. They were not capital investments, the cost of which, if converted, must first be restored from the proceeds before there is a capital gain taxable as income. See *Doyle vs. Mitchell Brothers Co., supra,* page 185 of 247 U. S., 38 Sup. Ct. 467."

In the case of *Koshland vs. Helvering* (1936), 298 U. S. 441, 56 Sup. Ct. 767, 80 L. Ed. 1268, the Commissioner contended that where common stock was received by a taxpayer as a dividend on preferred stock in the same corporation, the cost of said preferred stock for purposes of determining gain upon redemption thereof was not to be reduced by apportioning part of the cost to the common stock. The requirement of apportionment was embodied in regulations promulgated by the Commissioner. The court held that the rule laid down by the regulation was invalid and therefore the basis for the preferred stock was not reduced. The holding was based on this proposition:

> "Congress having clearly and specifically declared that in taxing income arising from capital gain the cost of the asset disposed of shall be the measure of the income, the Secretary of the Treasury is without power by regulatory amendment to add a provision that income derived from the capital asset shall be used to reduce cost."

The definition of income contained in the *Internal Revenue Code* is in accord with the above judicial principles. Sec.

22 (a), 53 Stat. 9, provides in part:

> "(a) General definition—'Gross income' includes *gains, profits,* and *income* derived . . . from . . . business . . . or sales or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from . . . the transaction of any business carried on for *gain* or *profit,* or *gains* or *profits* and *income* derived from any source whatever." (Italics added.)

See also Amendments to the Constitution of the United States, Art. XVI.

In considering the petitioners' contention that the above decisions of this court are in conflict with the conclusion of the Circuit Court of Appeals for the Eighth Circuit that the recoveries here involved constitute income, it should be noted that the petitioners concede that if the losses realized as a result of the sales of stock in prior years had been of tax benefit to them, they would be prevented under general equitable considerations from raising the contention that the recoveries here involved constitute a return of capital. There is ample authority for this concession.

Ilfeld Co. vs. Hernandez (1934), 292 U. S. 62, 54 Sup. Ct. 596, 78 L. Ed. 1127;

Griffiths vs. Commissioner (1939), 308 U. S. 355, 60 Sup. Ct. 277, 84 L. Ed. 319;

Helvering vs. Owens (1939), 305 U. S. 468, 59 Sup. Ct. 260, 83 L. Ed. 292;

Sec. 113 (b) (1) (A), *Internal Revenue Code,* 53 Stat. 44;

Sec. 19.113 (b) (1)-1, *Regulations 103;*

Secs. 23.33 and 23.34, *Regulations 104.*

2. The Circuit Court of Appeals in Deciding That the Sales of Stock in Years Prior to 1939 Were Sufficient to Sustain the Conclusion That Recoveries of the Original Purchase Price in 1939 Constituted Income, Even Though the Losses Sustained as a Result of the Sales in Such Prior Years Did Not Offset or Reduce Taxable Income For Said Years, Has Decided a Question of Federal Income Tax Law in a Way Which Is in Conflict With the Decisions of Other Circuit Courts of Appeal on the Same Matter.

The decision of the Circuit Court of Appeals for the Eighth Circuit in these cases is in conflict with the decision of the Circuit Court of Appeals for the Third Circuit in the case of *Pittsburgh Brewing Co. vs. Commissioner* (1939), 107 Fed. (2d) 155. In the latter case the taxpayer contended that in determining gain upon sale of property the basis or cost thereof should not be reduced by the amount of depreciation claimed in prior years' income tax returns in cases in which it was shown, and the Commissioner conceded, that (a) the amount of depreciation so claimed was excessive, and (b) the deduction to the extent of such excess was of no tax benefit to the taxpayer. The court sustained the taxpayer's contention and based its decision upon the proposition that the excess depreciation was not "allowed" within the meaning of the statute for the reason that the deduction had not offset or reduced income otherwise taxable.

While it is apparent that the specific section of the income tax law under consideration in the *Pittsburgh Brewing Company* case, viz.: the section of a prior Revenue Act corresponding to Sec. 113 (b) (1) of the *Internal Revenue Code*, 53 Stat. 44, is not involved in these cases, it is submitted that the general problem is the same. The Commis-

sioner in the *Pittsburgh Brewing Company* case was contending that excessive depreciation claimed in a tax return which was of no tax benefit was "allowed" within the meaning of a statutory provision requiring the reduction of basis by an amount equal to depreciation allowed or allowable. The Circuit Court of Appeals for the Third Circuit rejected this contention. In the cases here involved the Commissioner is contending and the Circuit Court of Appeals for the Eighth Circuit held that because the losses on the sale of stock were "sustained" under the provisions of Sec. 23 (e) (2) of the *Revenue Act of 1928*, 45 Stat. 791, "the capital transactions of the taxpayers were closed and their capital losses claimed and *allowed* in the years when the stocks were sold" (C. C. A., R. 10). (Italics added.)

The fundamental conflict between the Circuit Court of Appeals for the Third Circuit and the decision of the Circuit Court of Appeals for the Eighth Circuit is demonstrated by the recent decision of the Circuit Court of Appeals for the Fourth Circuit in the case of *Helvering vs. Virginian Hotel Corporation* (1943), 132 Fed. (2d) 909. The court in this case rejected the decision of the court in *Pittsburgh Brewing Company vs. Commissioner, supra,* and in so doing relied on the previous decision of the Circuit Court of Appeals for the Fourth Circuit in the case of *Helvering vs. State-Planters Bank & Trust Co.* (1942), 130 Fed. (2d) 44. The latter decision involved the question whether the recovery with respect to a bad debt previously charged off constituted taxable income where the deduction for the bad debt charged off had been of no tax benefit. The court held that such a recovery constituted taxable income and this decision was relied on by the Circuit Court of Appeals for the Eighth Circuit in support of its decision in the cases now presented to this court. The identity in principle involved in the bad debt case decided by the Fourth Circuit and the

depreciation cases decided by the Third and Fourth Circuits is further demonstrated by the provisions of Sec. 19.23 (k)-1 of *Regulations 103* (as they existed prior to amendment on March 1, 1943, pursuant to Sec. 116 of the *Revenue Act of 1942*, Public Law 753), and similar provisions of previous regulations. This section of the regulations provides in part:

> "Any amount subsequently received on account of a bad debt or on account of a part of such debt previously charged off and *allowed* as a deduction for income tax purposes must be included in gross income for the taxable year in which received." (Italics added.)

It will be observed that the problem of construction presented by the regulations with respect to deduction for bad debts "allowed" is identical to the problem of construction presented by the statute with respect to excessive depreciation "allowed."

The petitioners, therefore, assert that the above two decisions of the Circuit Court of Appeals for the Fourth Circuit and the decision of the Circuit Court of Appeals for the Eighth Circuit here involved all are based on a common principle and all are in conflict with the decision of the Circuit Court of Appeals for the Third Circuit in the case of *Pittsburgh Brewing Company vs. Commissioner, supra.* This court granted certiorari in *Virginian Hotel Corporation of Lynchburg vs. Commissioner, supra,* No. 766, on April 5, 1943.

The petitioners believe that it is incumbent upon them to call the court's attention to the case of *Commissioner vs. United States & International Securities Corporation* (1942, C. C. A. 3), 130 Fed. (2d) 894. This case involved the same problem presented in the case of *Helvering vs. State-Planters Bank & Trust Co., supra,* and the court reached the same conclusion. It appears to the petitioners that the Cir-

cuit Court of Appeals for the Third Circuit has reached inconsistent conclusions in the *Pittsburgh Brewing Co.* case, *supra*, and the *United States & International Securities Corporation* case, *supra*.

3. If the Decision of the Circuit Court of Appeals Is Not in Conflict With the Applicable Decisions of This Court (as Alleged at 1 above), Then the Circuit Court of Appeals in Deciding That the Recoveries Realized by the Taxpayers in 1939 as the Result of a Rescission of Previout Stock Purchases Constitute Income Has Decided That Recoveries of Capital May Be Taxed Under Federal Income Tax Law and Thus it Has Decided an Important Question of Federal Income Tax Law Which Has Not Been, But Should Be, Settled by This Court.

Petitioners, as an alternative ground for granting this writ of certiorari, submit that the question here involved is important and if the Supreme Court decisions cited at 1 above are not controlling the question presented by this case should be finally settled by this court. The petitioners believe that the question here involved is fundamental in the administration of our income tax law. If the definition of income is subject to absolute control by the Commissioner or the Congress and if there are to be no standards as to what is capital, other than the bare statement of the court unsupported by authority, we believe that the contrary inferences which have been drawn from decisions by this court should be clearly rejected. The Circuit Court of Appeals for the Eighth Circuit has admitted that the recovery here involved constituted a recovery of the purchase price which beyond question was an expenditure of capital. Nevertheless, that court concluded that these recoveries of capital constituted income. The importance of such a determina-

tion to the administration of the income tax law is self-evident.

The number of cases bearing upon this type of problem is constantly growing. See cases cited under 2 above. Although we are unable to furnish the court with any statement as to the number of cases involving the exact point presented by these cases, we can assure the court that there was extensive litigation in Minnesota involving similar actions for rescission and resulting in very substantial settlements in 1939 and 1940. The number of these cases in Minnesota was approximately 1,010. Again, we have no way of ascertaining the number of cases presenting the "tax benefit" problem involved in these cases, but we believe that a very substantial proportion of the total number of cases does involve this point. This fact, plus the general litigation involving "tax benefit" theories, is sufficient to justify the granting of writs of certiorari.

4. The Circuit Court of Appeals in Deciding That the Recoveries Realized by the Taxpayers in 1939 as the Result of a Rescission of Previous Stock Purchases Constitute Income Which Is Taxable as Ordinary Income Rather Than as Capital Gain Under Sec. 117 of the Internal Revenue Code Has Decided an Important Question of Federal Income Tax Law Which Has Not Been, But Should Be, Settled by This Court.

Petitioners believe that certiorari also should be granted with respect to the question as to whether the recoveries to the extent found to be taxable constitute capital gain under Sec. 117 of the *Internal Revenue Code*, 53 Stat. 50, rather than ordinary income. Both the Board and the Circuit Court of Appeals for the Eighth Circuit rejected this contention in these cases, but there are no other decisions passing

on this question. As noted above, approximately 1,010 taxpayers in Minnesota alone realized recoveries similar to those here involved, and petitioners believe that most of these taxpayers have this issue involved. Of these cases approximately 500 resulted in the assertion of deficiency taxes by the Commissioner of Internal Revenue. Petitioners, therefore, believe that this question is important and has not been, but should be, settled by this court.

The following is a brief statement of petitioners' contentions:

Section 117 of the *Internal Revenue Code* provides that when income is properly classified as long-term capital gain only fifty per cent thereof is to be taxed, instead of taxing the entire gain as in the case of other income. Subdivision A-5 of Section 117 defines long-term capital gain as follows:

> "The term 'long-term capital gain' means gain from the sale or exchange of a capital asset held for more than 18 months, after and to the extent such gain is taken into account in computing net income."

It is not disputed that, to the extent the petitioners realized taxable income from the recoveries here involved, such income was realized upon disposition of a capital asset and we believe that the Commissioner will concede that the capital asset was held more than 18 months. The sole question to be decided, therefore, is whether the capital asset, upon which the gain was realized, was disposed of by the taxpayer in a "sale or exchange." It is the petitioners' contention that whatever taxable income was realized as the result of a recovery from National City Company in 1939 was realized from a "sale or exchange" and therefore is taxable as capital gain. The determination of this issue requires an inquiry into the nature of the transaction which resulted in the recovery. As previously pointed out in this brief, the petitioners' claims against National City Company were based on the right to rescind the purchases and

secure a refund of the purchase price. It also is admitted by the Commissioner that where a taxpayer continued to hold his National City Bank of New York stock, the recovery in 1939 attributable to such stock was not taxable. It follows, therefore, that the receipt of income in 1939 (to whatever extent taxable) represented "gain from the sale" of the stock *in 1931* which was not taxable until 1939, at which time it was received by a cash basis taxpayer. The quoted phrase is from Section 117 of the *Internal Revenue Code,* and it is submitted that it accurately describes the source of whatever gain may be deemed taxable in this case. It seems clear that even under the Commissioner's theory the taxable income was not "from" the recovery in 1939 because, unless there was a prior sale of the stock, there is no taxable income as the result of that recovery. The gain then must be "from" the sale of the stock in 1931. Although the Commissioner and the taxpayer may differ as to whether the 1931 sale caused part or all of such "gain" realized in 1939 to be taxable merely because the loss was claimed in 1931 or because the loss was of tax benefit in that year, we seem to be agreed that it was the 1931 sale which gives part or all of this 1939 recovery its character as taxable income. The mere fact that the gain was received and taxed in a year long after 1931 should not prevent it from taking its character as capital gain from the events in 1931. A common example of a similar situation is found in the taxation of gain on installment sales under Section 44 of the *Internal Revenue Code,* 53 Stat. 24. Gains under this section are taxed in proportion to the amount received in years subsequent to the year of sale and such gains are classified as capital or ordinary gain pursuant to the law applicable to the year in which the gain is received. *Snell vs. Commissioner* (1938, C. C. A. 5), 97 Fed. (2d) 891.

CONCLUSION

For the reasons stated your petitioners respectfully pray that writs of certiorari issue to enable this court to review the judgment of the Circuit Court of Appeals in these cases.

Dated April 6, 1943.

Respectfully submitted,

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IN THE

Supreme Court of the United States

No. 930. 44

JOHN V. DOBSON,

Petitioner,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Respondent.

No. 931. 45

E. W. DOBSON,

Petitioner,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Respondent.

No. 932. 46

ESTATE OF JAMES N. COLLINS, DECEASED, FIRST NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, EXECUTOR,

Petitioner,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Respondent.

No. 933. 47

H. J. HARWICK,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

PETITIONERS' REPLY MEMORANDUM

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IN THE

Supreme Court of the United States

No. 930.

JOHN V. DOBSON,

Petitioner,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Respondent.

No. 931.

E. W. DOBSON,

Petitioner,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Respondent.

No. 932.

ESTATE OF JAMES N. COLLINS, DECEASED, AND FIRST NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, EXECUTOR,

Petitioner,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Respondent.

No. 933.

H. J. HARWICK,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

PETITIONERS' REPLY MEMORANDUM

On pages 21 to 24 of petitioners' brief in support of their petition for writs of certiorari, it was asserted that the decision of the Circuit Court of Appeals for the Eighth Circuit in these cases is in conflict with the decision of the Circuit Court of Appeals for the Third Circuit in the case of *Pittsburgh Brewing Co. vs. Commissioner* (1939), 107 F. (2d) 155. Said brief also pointed out that the case of *Virginian Hotel Corporation of Lynchburg vs. Commissioner,* decided by the Circuit Court of Appeals for the Fourth Circuit, was also in conflict with the *Pittsburgh Brewing Co.* case, and that this court granted certiorari in the *Virginian Hotel Corporation* case, No. 766, on April 5, 1943. The respondent, in its memorandum, agrees that the *Virginian Hotel Corporation* case presents a problem analogous to these cases. Since the petitioners' brief was filed, a decision by the Circuit Court of Appeals for the Eighth Circuit in the case of *Douglas, et al., vs. Commissioner* (April 7, 1943), ... F. (2d) ..., gives further support to the conclusion that the problems involved in these cases and in the *Virginian Hotel Corporation* case are substantially the same. (Because the Federal Reporter citation is not yet available, the court is advised that the opinion in the *Douglas* case is found at Par. 9386 of Vol. 4, Commerce Clearing House Standard Federal Tax Service for 1943 and is also found at Par. 62,588 of Vol. 4, Prentice Hall 1943 Federal Tax Service.)

The *Douglas* case involved the question as to whether or not the cancelation of an iron mine lease required the lessor to report as taxable income for the year of cancelation an amount equal to the deduction for depletion claimed in a year prior to the year of cancelation with respect to royalties paid for ore which was, in fact, not mined. After holding that the lessor was required to report such amounts as taxable income, the court considered the second phase of the case which involved the question as to the effect of a showing that in a particular year in which the deduction for depletion was claimed the lessor had a net loss for Federal income tax purposes before claiming the deduction for depletion. The court concluded that, under these circumstances, the fact that the depletion had been of no tax benefit did not prevent the inclusion of the amount specified in income and cited, in support of this conclusion, its opinion in the cases here involved. The court significantly then stated:

> "(The principle) has also been rejected by the Fourth Circuit Court of Appeals in *Helvering vs. State-Planters Bank & Trust Co.*, 130 F. (2d) 44, and in *Helvering vs. Virginian Hotel Corporation*, 132 F. (2d) 909."

Dated May 12, 1943.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1943

No. 44

JOHN V. DOBSON,

Petitioner,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

No. 45

E. W. DOBSON,

Petitioner,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

No. 46

ESTATE OF JAMES N. COLLINS, DECEASED, FIRST NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, EXECUTOR,

Petitioner,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

No. 47

H. J. HARWICK,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

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BRIEF FOR PETITIONERS

OPINIONS OF THE COURTS BELOW

The Board of Tax Appeals (now the Tax Court of the United States) reported its opinions in the cases of John V. Dobson, 46 B. T. A. 770 (R. 105), and Estate of James N. Collins, 46 B. T. A. 765 (R. 52). The memorandum opinions of the Board in the cases of E. W. Dobson (R. 79) and H. J. Harwick (R. 9) have not been officially reported. The Circuit Court of Appeals for the Eighth Circuit decided all of these case in a single opinion (R. 127), which is reported at 133 Fed. (2) 732.

GROUNDS UPON WHICH JURISDICTION IS INVOKED

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925, 43 Stat. 938. The judgments (R. 136, 137, 138, and 139) of the United States Circuit Court of Appeals were entered on March 2, 1943, and a petition for writs of certiorari were filed in this Court on April 15, 1943. The writs of certiorari were granted on June 14, 1943.

STATEMENT OF THE CASE

These cases involve the legality under the Internal Revenue Code and the United States Constitution of treating as taxable income amounts recovered on an investment (through refund of part of the purchase price) under circumstances which establish conclusively that the taxpayers had not realized and would not realize any *gain* from such investment. The investments here involved consisted of corporate stock which had been sold at a loss by the purchasers prior to the year of recovery. Subsequently actions for rescission of the original purchase were settled by a return of a part

only of the original purchase price. The amounts of the recoveries were less than the losses sustained upon the sale by the purchasers and said losses, although referred to in the taxpayers' income tax returns for the year in which the sale occurred, did not offset any taxable income for the reason that said return already showed a net loss without using this particular deduction.[1]

The stipulated facts (Harwick, R. 18-26; James N. Collins, R. 59-64; E. W. Dobson, R. 84-89; John V. Dobson, R. 118-123) in each of the above cases, were adopted by the United States Board of Tax Appeals as its Findings of Fact (Harwick, R. 9-13; James N. Collins, R. 53-59; E. W. Dobson, R. 79-83; John V. Dobson, R. 105-110). Because neither party has distinguished between the facts involved in any of these cases in so far as the *general principle* involved in these cases is concerned and in the interests of clarity and brevity, we will hereinafter set forth only the facts involved in No. 46, Estate of James N. Collins, Deceased, First National Bank and Trust Company of Minneapolis, Executor, vs. Guy T. Helvering, Commissioner of Internal Revenue, and in No. 47, H. J. Harwick vs. Commissioner of Internal Revenue. However, for the convenience of the Court we have summarized the facts of the other two cases in Appendix A attached to this brief.

Several years before the taxable year 1939 the four taxpayers here, all residents of Minnesota, had made individual purchases in that state from National City Company of the stock of National City Bank of New York, and each had sold a portion or all of such stock at losses, which, except as hereinafter noted, were deducted on their income tax returns (R. 19, 60, 85, 119).

---

[1]Slight variations in these facts exist in the J. V. Dobson and Harwick cases. The Circuit Court of Appeals for the Eighth Circuit in view of its decision in the other cases did not find it necessary to pass on the materiality of these variations.

James N. Collins[2] sold 100 shares of this stock in 1930, which had cost $56,200, for $14,599.20, and thereby sustained a deductible loss of $41,600.80, which the taxpayer referred to in his 1930 Federal income tax return and the deductibility of which was not questioned by the Commissioner of Internal Revenue (hereinafter referred to as the Commissioner) upon audit of the return.

Collins also sold 100 shares in 1931, which had cost $37,100, for $8,936.22, and sustained a loss of $28,163.78, which was referred to on his 1931 return and allowed by the Commissioner. Including these losses, the net loss disclosed in his income tax return for 1930 was $65,896.51, and for 1931, $40,204.90 (R. 62, 63). In addition to this stock Collins owned 100 shares of stock acquired at a cost of $30,000, which he continued to hold throughout the year 1939 (R. 60).

Several years after the above sales, Collins and the other taxpayers learned that grounds for rescinding these purchases existed. Accordingly, Collins filed suit against National City Company (R. 61), as did each of the other taxpayers except Harwick, who merely asserted a claim against that company, each contending:

1. That the stock had been sold to them without having been registered, as required by state law, and

2. That the sales had been fraudulent.

The complaint in each suit embodied a request for a rescission of the sales contracts and also an offer to turn over the proceeds of the stock sales or an equal number of shares, plus income thereon (R. 54).

---

[2]Collins died on April 21, 1941, which was before his case was heard by the Board, and his executor was substituted as the petitioner, but for convenience Collins will be referred to here as the taxpayer (R. 15).

These suits, as well as Harwick's claim, were settled in 1939 by the company making payment to each of the taxpayers. Upon receipt of these payments the suits were dismissed with prejudice pursuant to a stipulation of the parties (R. 54). Harwick also executed an instrument releasing the National City Company from all claims which he had against it (R. 22).

As a result of this settlement James N. Collins received a net amount of $45,150.63, of which $23,296.45 was allocable to the stock sold in 1930 and $6,454.18 was allocable to the stock sold in 1931 (R. 51). The balance of the recovery was allocable to the stock which Collins still owned (R. 61). Collins did not report any of the recovery as income in 1939, but the first two amounts allocable to the stock sold in 1930 and 1931, viz.: $29,750.63, were held by the Commissioner to be taxable income (R. 62). The Commissioner has conceded that none of the recovery allocable to the stock which Collins continued to own constituted taxable income (R. 62).

Throughout the year 1939 adjustment of Collins' income tax liability for 1930 and 1931 was barred by the Statute of Limitations (R. 62, 63).

As to these recoveries in 1939, the Board held in effect that such payments constituted a return of capital and were not subject to tax unless the loss deductions of the prior years had actually offset gross income of those years and so had resulted in a tax benefit.

In applying this test the Board held as to James N. Collins (R. 58) that (1) since the amount received upon sale of the stock in 1930 and 1931, plus the amount recovered, was less than the original purchase price of the stock, viz.:

Stock sold in	1930		1931
Cost of stock.	$56,200.00		$37,100.00
Sale price ...	$14,599.20	$8,936.22	
1939 Recovery.	23,296.45	6,454.18	
Total Recovery	37,895.65		15,390.40
Net loss from transaction.	$18,304.35		$21,709.60

(2) and since the losses referred to in the taxpayer's 1930 and 1931 tax returns did not offset any income, viz.:

	1930	1931
Net *losses* per return.....	$65,896.51	$40,204.90
Eliminate entire loss on sale of National City Bank stock	41,600.80	28,163.78
Adjusted net *loss*.....	$24,295.71	$12,041.12

the taxpayer had not recovered or recouped his capital investment in this stock and therefore was not taxable on the sum recovered in 1939 allocable to the stock sold in 1930 and 1931.

While applying the same general principles in determining the tax liability of H. J. Harwick, the Board of Tax Appeals concluded that under the facts of that case the taxpayer was taxable on the entire amount of the recovery. These facts were as follows (R. 10-12):

On July 22, 1929, Harwick purchased 100 shares of the capital stock of the National City Bank of New York. The purchase was made in the State of Minnesota from the National City Company, the consideration being $38,000.

On December 15, 1931, Harwick sold the 100 shares of stock and sustained a loss by reason of said sale in the amount of $34,451.28. This loss was claimed as a deduction by him in his 1931 income tax return and was allowed by the Commissioner.

Harwick's claim against National City Company for rescis-

sion of this purchase was settled on March 7, 1939, by a net payment of $17,000 by the company, and upon receipt thereof, Harwick executed an instrument releasing the National City Company from all claims, demands, or causes of action which he ever had against it.

In his income tax return for 1939 Harwick reported income of only $9,884.22 on account of the recovery of the $17,000. In the deficiency notice the respondent adjusted the amount of income reported by adding thereto $7,115.78, thereby treating the entire amount of Harwick's net recovery of $17,000 as gross income, taxable as ordinary gain. If the entire deduction of $34,451.28 claimed and allowed on Harwick's 1931 income tax return, had been disallowed, a deficiency in his income tax liability for 1931 would have resulted in the amount of $3,349.53, computed as follows:

Net income per return		$12,042.03
Add: Loss on sale of National City Bank stock		34,451.28
Net income revised		$46,493.31
Less: Dividends	$11,861.81	
Personal exemption	3,500.00	
Credit for dependents	800.00	16,161.81
Balance subject to normal tax		$30,331.50
Total normal tax		1,296.58
Surtax on $46,493.31		2,539.20
Total		3,835.78
Less: Earned income credit		486.25
Total tax assessable		3,349.53
Assessed		None
Deficiency		$ 3,349.53

If Harwick had received $7,115.78 on the sale of the stock in 1931, in addition to the amount actually received, his deductible loss for 1931 from the sale of the said stock would

have been $27,335.50 instead of $34,451.28, and he would have had net income in the amount of $19,157.81. Due to certain credits allowable, however, his income tax for 1931 would have been zero, shown as follows:

Net income shown in original return		$12,042.03
Add: Amount recovered in 1939 and not reported as taxable income for 1939		7,115.78
Net income revised		$19,157.81
Less: Dividends	$11,861.81	
Personal exemption	3,500.00	
Credit for dependents	800.00	16,161.81
Balance subject to normal tax		$ 2,996.00
Normal tax at 1½%		44.94
Surtax on $19,157.81		186.30
Tax on net income		231.24
Less earned income credit		231.24
Total tax assessable		00.00
Tax assessed		None
Deficiency		None

Throughout the year 1939 adjustment of Harwick's income tax liability for 1931 was barred by the Statute of Limitations.

The Board of Tax Appeals held that although $7,115.78 of the total loss of $34,451.28 had not reduced Harwick's tax liability in 1931, nevertheless all of the 1939 recovery of $17,000 constituted taxable income. The reason given by the Board for refusing to recognize the capital nature of any portion of said recovery was that the entire loss had been used to offset gross income, inasmuch as even after deduction of said loss the 1931 return disclosed a "net income" of $12,042.03, and therefore in the opinion of the Board the

loss had served to "effect an offset of taxable income" (R. 13).

Although the general facts with respect to the John V. Dobson case are set out in Appendix A, one special fact should be noted at this point. On July 3, 1931, John V. Dobson purchased 200 shares of the bank stock at a cost of $17,700, and on July 13, 1931, he sold the said shares for $16,000, thereby sustaining a loss of $1,700 which was deductible for 1941 but not classed as a deduction in his income tax return for that year. Upon audit of the return no deduction was allowed by the Commissioner by reason of the loss realized on the sale but had such loss been claimed as a deduction it would have been allowed and would have reduced the income tax liability of John V. Dobson for the year 1931, but would not have eliminated entirely his liability for tax. His 1931 return disclosed net income of $17,514.27 and a tax thereon of $125.43, which was paid to the Collector during the year 1932 (R. 106).

As a result of John V. Dobson's suit against National City Company for rescission of this and other purchases of stock, John V. Dobson recovered from that company in 1939 the net sum of $33,404, of which $952 is allocable to the stock referred to above sold by John V. Dobson in 1931. The Commissioner conceded before the Board and the Board held (R. 110) that no part of this portion of the recovery constituted income taxable to John V. Dobson in 1939.

From these decisions of the Board the Commissioner appealed in the cases involving the tax liability of E. W. Dobson (R. 89), James N. Collins (R. 64), and John V. Dobson (R. 111). The taxpayer H. J. Harwick appealed (R. 14) and John V. Dobson took a cross-appeal (R. 33) from the portion of the decision of the Board dealing with the application of the principle referred to above to their particular facts, and from the portion of the decision of the Board

holding that to the extent that taxable income resulted from the recoveries such income was taxable as ordinary income rather than as capital gain under Section 117 of the Internal Revenue Code. The cases were consolidated before the Circuit Court of Appeals for the Eighth Circuit and on March 2, 1943, that Court entered the following decision (R. 127):

As to the appeals taken by the Commissioner, the Court reversed the decision of the Board and held that the entire amounts recovered by the taxpayers in 1939 from National City Company constituted taxable income for the reason that according to the Court (R. 133) the recoveries were "income when received" and, constituting income, could not be reduced by losses sustained in a year prior to 1939 (R. 132). The Court therefore refused to pass on the first issue raised in the appeals by Harwick and John V. Dobson (R. 134), and as to the second issue raised by them the Court affirmed the decision of the Board and held that the entire amount recovered was taxable as ordinary income and not as capital gain (R. 135).

SPECIFICATIONS OF ERROR

The Circuit Court of Appeals erred:

1. In holding that the recoveries realized by the taxpayers in 1939 as the result of rescissions of previous stock purchases constitute income in that such recoveries in fact constitute recoveries of capital which cannot be taxed under Section 22 (a) of the Internal Revenue Code, 53 Stat. 9; 574-575, nor under Article XVI, Amendments to the Constitution of the United States, except where by reason of previous actions of the taxpayers which resulted in tax benefit to them they are prevented from asserting the capital nature of such recoveries;

2. In refusing to determine that the Board of Tax Appeals erred in finding that the taxpayers Harwick and John V. Dobson were prevented from asserting the capital nature of the recoveries in situations in which the losses sustained by reason of sales during prior years offset gross income but in part or in whole did not serve to reduce tax liability of the taxpayers in such years, in that such facts are insufficient to prevent the taxpayers from asserting the capital nature of such recoveries;

3. In holding that to the extent that said recoveries constitute taxable income, such income is taxable as ordinary income rather than as capital gain under Section 117 of the Internal Revenue Code, 53 Stat. 50.

ARGUMENT

I.

The Recoveries Realized by the Taxpayers in 1939 as the Result of Rescissions of Previous Stock Purchases Constitute Recoveries of Capital Which Cannot Be Taxed Under Section 22 (a) of the Internal Revenue Code, Nor Under Article XVI, Amendments to the Constitution of the United States.

The facts in these cases are clear. It has been stipulated (R. 19, 61, 86, 120) that the taxpayers' claims upon which recoveries were realized arose out of the discovery in 1936, 1937, or 1938 of facts which led each of them to believe that the National City Bank of New York stock purchased by them had not been registered in accordance with the requirements of the Minnesota Blue Sky Laws and that said sales had been fraudulent. In addition to this stipulation the factual basis for the contention that the recoveries from National City Company did not consti-

tute income is most clearly illustrated by the facts involved in the James N. Collins case. Collins acquired his stock in 1929 and sold it in 1930 and 1931 at a substantial loss (R. 60). Had Collins not claimed *any* loss as a result of such sales in his 1930 and 1931 returns, such returns, nevertheless, would have disclosed losses of $24,295.80 and $12,041.12, respectively (R. 62, 63). Furthermore, the sum of the sales price of the stock in 1930 and 1931, plus the amounts recovered in 1939, was less than the original cost of the stock to Collins (R. 61). The importance of these facts with respect to the effect of the sales upon Collins 1930 and 1931 tax liability is that (1) they clearly show that as a result of the sales in 1930 and 1931 *and* the recovery in 1939 Collins did not realize any *gain* but, on the contrary, sustained a *loss,* and (2) they negative any conclusion that Collins is estopped to assert or can be said to have waived his right to claim that there was no *gain* as a result of the recovery in 1939, and that such recovery constituted a receipt of capital. The variations in these facts which exist in the Harwick case and, to a small extent, in the John V. Dobson case, will be discussed later in this brief.

Under both local property law and decisions of this Court interpreting the income tax laws, the status of these recoveries as capital receipts rather than income is clear. The Minnesota Supreme Court has held upon numerous occasions that claims such as here involved are based upon a rescission of the contract of sale and a recovery of the purchase price.

Babcock vs. Bancamerica-Blair Corporation (1942), 212 Minn. 428, 4 N. W. (2d) 89;

Vercellini vs. U. S. I. Realty Co. (1924), 158 Minn. 72, 196 N. W. 672;

E. E. Webster vs. U. S. I. Realty Co. (1927), 170 Minn. 360, 212 N. W. 806;

Drees vs. Minnesota Petroleum Co. (1933), 189 Minn. 608, 250 N. W. 563;

Edson vs. O'Connell (1934), 190 Minn. 444, 252 N. W. 217;

See, also, *Vogel vs. Chase Securities Corporation* (1936), 19 Fed. Supp. 564.

The Board of Tax Appeals also characterized these recoveries as resulting from a rescission of the original sale (R. 55) and the Commissioner has not questioned this conclusion. It cannot be disputed that the recoveries were a return from the original seller to the taxpayers of a part of their capital invested in the stock. The restitution is more direct, and more clearly identified with the capital investment than the recovery on a tort claim for damages for trespass and removal of coal involved in *Strother vs. Commissioner of Internal Revenue* (C. C. A. 4th Cir., 1932), 55 F. (2d) 626, affirmed on other grounds in (1932) 287 U. S. 314, 53 Sup. Ct. 11, 77 L. Ed. 511, and the recovery on a tort claim for damages for interference with business in *Farmers & Merchants Bank vs. Commissioner of Internal Revenue* (C. C. A. 6th Cir., 1932), 59 F. (2d) 912, both of which were held to be return of capital, and not income.

The situation thus presented is that the taxpayers, having invested their capital in stock of the National City Bank, have had returned to them a part of that capital through sale of the stock in 1930 and 1931, and another part through settlement of litigation seeking rescission of the original purchase, but are still out of pocket because they have not recovered it all. It is this second, and still incomplete, return of capital which the Commissioner seeks to designate as income.

Congress has defined "gross income" in a manner which clearly excludes the recoveries of the taxpayers here involved.

Section 22 (a) of the Internal Revenue Code, 53 Stat. 9, provides in part:

> "(a) General definition—'Gross income' includes *gains, profits,* and *income* derived * * * from * * * business * * * or sales or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from * * * the transaction of any business carried on for *gain* or *profit,* or *gains* or *profits* and *income* derived from any source whatever." (Italics added.)
>
> See Amendments to the Constitution of the United States, Art. XVI.

The taxpayers assert that the portion of the recoveries from National City Company here involved did not constitute "gain or profit" within the above statutory definition. This Court in construing similar statutory provisions has held that recoveries of capital which do not represent gain or profit cannot be subjected to tax.

The basic definition of income, approved by this Court in a long series of cases, is found in *Eisner vs. Macomber* (1920), 252 U. S. 189, 206, *et seq.,* 40 Sup. Ct. 189, 64 L. Ed. 521, where this Court said:

> "For the present purpose we recognize only a clear definition of the term 'income' as used in common speech in order to determine its meaning in the amendment * * *. Income may be defined as the gain derived from capital, from labor, or from both combined, provided it be understood to include profit through a sale or conversion of capital assets * * *."

In accordance with this definition, it has been held repeatedly that, where the taxpayer has invested his capital in property or securities which are sold or lost or otherwise liquidated, and subsequently payments are made to him by way of reimbursement, there can be no "income" in connection with such payments until the full amount of the orig-

inal capital has been returned. It is only profit or gain beyond the capital investment which constitutes income. This was the rule applied to statutes taxing income before the Sixteenth Amendment, and it has carried over as a part of the definition of income under that amendment. "In order to determine whether there has been gain or loss, and the amount of the gain, if any, we must withdraw from the gross proceeds an amount sufficient to restore the capital value that existed at the commencement of the period under consideration."

Doyle vs. Mitchell Bros. Co. (1918), 247 U. S. 179, 185, 38 Sup. Ct. 467, 62 L. Ed. 1054;

Hays vs. Gauley Mt. Coal Co. (1918), 247 U. S. 189, 38 Sup. Ct. 470, 62 L. Ed. 1061;

Lynch vs. Turrish (1918), 247 U. S. 221, 38 Sup. Ct. 537, 62 L. Ed. 1087;

Burnet vs. Logan (1930), 283 U. S. 404, 51 Sup. Ct. 550, 75 L. Ed. 1143;

Commissioner of Internal Revenue vs. Speyer (C. C. A. 2d Cir., 1935), 77 F. (2d) 824;

Commissioner of Internal Revenue vs. Ullman (C. C. A. 2d Cir., 1935), 77 F. (2d) 827;

Dreier vs. Helvering (App. D. C., 1934), 72 F. (2d) 76;

Helvering vs. Dreier (C. C. A. 4th Cir., 1935), 79 F. (2d) 501.

This Court applied the above definition of income in the case of *Bowers vs. Kerbaugh-Empire Co.* (1926), 271 U. S. 170, 46 Sup. Ct. 449, 70 L. Ed. 886. The taxpayer in that case had borrowed money under a contract requiring repayment in German marks. After the declaration of war upon Germany the unpaid balance on this loan was paid off in German marks which at that time had greatly depreciated in value. As a result the difference between the United

States dollars, into which proceeds of the original loan had been converted, and the United States dollars necessary to purchase the depreciated marks with which to pay off the loan was $684,456.18. The money when borrowed had been used in construction projects by the taxpayer and its subsidiary but these projects had resulted in substantial net losses prior to the year in which the debt was paid. The Court, page 172, pointed out that the losses sustained in such prior years were in excess of the asserted income, viz.: $684,456.18, and stated that these were among the "essential facts" which supported the conclusion that this transaction did not result in income. The Court further stated, page 174, that "In determining what constitutes income, substance rather than form is to be given controlling weight," and concluded, page 175, that "The mere diminution of loss is not gain, profit, or income."

The importance of the fact in the *Kerbaugh-Empire Co.* case, *supra,* that the transactions in prior years had resulted in net losses and the recognition of this Court that whether or not such losses existed would determine the taxable character of subsequent capital transactions is demonstrated by later citations of that case by this Court. *United States vs. Kirby Lumber* Co. (1931), 284 U. S. 1, 3, 52 Sup. Ct. 4, 76 L. Ed. 131; *Helvering vs. American Chicle Co.* (1934), 291 U. S. 426, 430, 54 Sup. Ct. 460, 78 L. Ed. 891.

The decision in the *Kerbaugh-Empire Co.* case was based on and represented an extension of previous decisions in which this Court had held that a recovery of capital on an asset *held by the taxpayer at the time of the recovery* does not constitute income under the Sixteenth Amendment. See *Miles vs. Safe Deposit & Trust Co.* (1922), 259 U. S. 247, 42 Sup. Ct. 483, 66 L. Ed. 923; *Towne vs. Eisner* (1918), 245 U. S. 418, 38 Sup. Ct. 158, 62 L. Ed. 372; and *Eisner vs. Macomber, supra.*

The definition of income in *Eisner vs. Macomber, supra,* also was approved by this Court in *Goodrich vs. Edwards* (1920), 255 U. S. 527, 41 Sup. Ct. 390, 65 L. Ed. 758. That case involved Sec. 2 (c) of the *Revenue Act of 1916,* 39 Stat. 758, which provided that "For the purpose of ascertaining the gain derived from a sale or other disposition of property, real, personal, or mixed, acquired before March 1, 1913, the fair market price or value of such property as of March 1, 1913, shall be the basis for determining the amount of such gain derived." The Commissioner had ruled that under this statute the March 1, 1913, value was to be used in determining gain, even though that value was less than the cost to the taxpayer. The Court rejected this contention, emphasizing that the *Revenue Act of 1916* (similar in this respect to the statute here involved) imposed no tax except where *gains* were realized. Although the Solicitor General confessed error in the *Goodrich* case, the Court later reaffirmed its conclusions and stated that its decision was not based on this confession of error. *United States vs. Flannery* (1925), 268 U. S. 98, 103, 45 Sup. Ct. 420, 69 L. Ed. 864.

In the case of *Koshland vs. Helvering* (1936), 298 U. S. 441, 56 Sup. Ct. 767, 80 L. Ed. 1268, the Commissioner contended that where common stock was received by a taxpayer as a dividend on preferred stock in the same corporation, the cost of said preferred stock for purposes of determining gain upon redemption thereof was not to be reduced by apportioning part of the cost to the common stock. The requirement of apportionment was embodied in regulations promulgated by the Commissioner. The Court held that the rule laid down by the regulation was invalid and therefore the basis for the preferred stock was not reduced. The holding was based on this proposition, page 447:

"Congress having clearly and specifically declared

that in taxing income arising from capital gain the cost of the asset disposed of shall be the measure of the income, the Secretary of the Treasury is without power by regulatory amendment to add a provision that income derived from the capital asset shall be used to reduce cost."

In short, it is the contention of the taxpayers that there can be no income, within the meaning of the word as it is used in the Revenue Acts, and that Congress has no power under the Sixteenth Amendment to find income, in a capital transaction which has resulted in no profit or gain, but on the contrary represents a loss.

II.

The Reference to the Capital Loss in the Returns for 1930 and 1931 Does Not Make the Later Recovery of Capital Income, or Prevent the Taxpayers from Asserting Its Capital Nature, in the Absence of Tax Benefit to Them and Loss of Revenue to the Government.

The Circuit Court of Appeals for the Eighth Circuit stated that the above facts and authorities were immaterial, and without citation of any authority or further explanation, other than the statement that the capital transaction was closed when the stock was sold, the Court concluded that the recoveries were income when received (R. 133). The Circuit Court of Appeals then proceeded to demonstrate, with ample citation of authority, that losses and deficits for prior years could not be used to offset or reduce income for the current year (R. 132). The petitioners submit that the basic and erroneous premise in the conclusion of the Circuit Court of Appeals is the proposition that these recoveries were income when received and that this premise has no support in the facts or the authorities.

The statement of the Court, in support of its assumption that the recoveries here involved were income, that the capital transaction was closed when the stock was sold apparently is based on the proposition that in income tax accounting the transactions of each year must be separate and distinct and closed at the end of the year and not to be considered in relation to any subsequent year. In support of this theory, reliance is placed upon *Burnet vs. Sanford & Brooks Co.* (1931), 282 U. S. 359, 51 Sup. Ct. 150, 75 L. Ed. 383.

In that case the taxpayer performed a contract for the United States Government which resulted in the realization of losses by the taxpayer while the contracts were being performed during the years 1913 to 1916. Subsequent to the abandonment of the work the taxpayer sued the United States and recovered additional compensation under the contract. This recovery was received by the taxpayer in 1920 and this Court sustained the Commissioner in including the recovery in taxpayer's income for 1920, despite the fact that because of losses sustained on the Government work in 1913 to 1916, the taxpayer's income tax return had shown large net losses for all years except 1914. The basis for the decision was the conclusion that the recovery in 1920 constituted gross income for that year and that there was no statutory authority for disregarding the annual accounting periods so as to permit the bringing forward of losses sustained in prior years. It is apparent that the essential premise for the Court's conclusion is the finding that the money which was received was an income as distinguished from a non-income item such as a return of capital or refund of previous expenditures. This Court expressly recognized the principle upon which we are here relying. The Court said, page 363:

"That the recovery made by respondent in 1920 was

gross income for that year within the meaning of these sections cannot, we think, be doubted. The money received was derived from a contract entered into in the course of respondent's business operations for profit. While it equalled, and in a loose sense was a return of, expenditures made in performing the contract, still, as the Board of Tax Appeals found, the expenditures were made in defraying the expenses incurred in the prosecution of the work under the contract, for the purpose of earning profits. *They were not capital investments, the cost of which, if converted, must first be restored from the proceeds before there is a capital gain taxable as income.* See *Doyle vs. Mitchell Brothers Co., supra,* page 185 of 247 U. S., 38 Sup. Ct. 467." (Italics ours.)

It is evident that the basis of this decision is that the expenditures in prior years of the kind recognized as ordinary operating expenses gave rise to losses in such prior years and *only* in such prior years, and in the absence of statutory authority such losses could not be used to offset income received in subsequent years. The opinion does not mean that in determining whether a given capital transaction resulted in gain or loss the inquiry is limited to the events which occurred in a single year. This is made all the more clear by the fact that the Court distinguished but did not disturb the case of *Bowers vs. Kerbaugh-Empire Co., supra,* where losses of invested capital sustained in earlier years were taken into account in determining that no income resulted from a return of capital. It is of course entirely reasonable that current receipts and current operating expenses of a business should be closed each year; but it is the very essence of gains and losses on invested capital that they be considered over a long term.

The distinction is borne out by *Wichita State Bank & Trust Co. vs. Commissioner of Internal Revenue* (C. C. A. 5th Cir., 1934), 69 F. (2d) 595, certiorari denied, 293 U. S. 562, 55 Sup. Ct. 73, 79 L. Ed. 662. Here the taxpayer, in

common with other banks, made contributions to a permanent guaranty fund for the benefit of failed banks. The fund was not intended to be consumed, but was to be drawn on to provide prompt payment to depositors, and at once to be replenished by special assessments against member banks. Certain banks having failed, such special assessments were levied against the taxpayer; in later years, partial reimbursement was made by dividends from the assets of the failed banks. It was held that the special assessments were to be treated as ordinary, current expense of the business, which must be charged off in the year they were incurred, so that the reimbursement was income in the year it was received. Return of the contributions made to the standing guaranty fund, however, was held to be a return of capital, on which there could be no income in the absence of a gain on the transaction over the long term.

A similar result was reached in *Buffalo Union Furnace Co. vs. Helvering* (C. C. A. 2d Cir., 1934), 72 F. (2d) 399. In that case the taxpayer, both before and after March 1, 1913, had expended money for car spotting, which should have been done by carriers. After March 1, 1913, it deducted the cost of this work on its income tax returns. In 1921, after suit and settlement, it recovered a part of its claim from the carriers. It was held that, as to all expenditures after March 1, 1913, these operating expenses were closed in the year in which they were deducted, and the reimbursement was income to that extent in 1921. But as to expenditures before March 1, 1913, the taxpayer entered the income tax zone with claims against the railroads for past torts, which became a part of its capital; and until it could be shown that these claims were paid at an amount in excess of their March 1, 1913, value, no income resulted in 1921.

The conclusion is that the Circuit Court of Appeals is in error in its opinion that gains and losses on invested capital

must be closed out each year, rather than considered on the basis of the transaction as a whole.

There remains the question whether, by reason of the fact that the taxpayers listed the losses realized as a result of the sales of stock on their returns for 1930 and 1931, without deriving any tax benefit from them, they are now prevented from treating the recoveries in 1939 as a return of capital. The petitioners freely concede that, if the losses so listed had been of tax benefit to them, they would be precluded from raising the contention that the subsequent recoveries are not income.[3] One sufficient reason for this is that by taking advantage of such a benefit the taxpayer allots a portion of otherwise taxable income to the restoration of his lost capital, which is thus returned, and any subsequent recovery must be gain.[4] Another, perhaps, under general equitable considerations, is a form of estoppel, in that the government has been deprived of revenue through the taxpayer's claim that he has sustained a loss.[5]

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[3]There is ample authority for this.
Ilfeld Co. vs. Hernandez (1934), 292 U. S. 62, 54 Sup. Ct. 596, 78 L. Ed. 1127;
Griffiths vs. Commissioner (1939), 308 U. S. 355, 60 Sup. Ct. 277, 84 L. Ed. 319;
Helvering vs. Owens (1939), 305 U. S. 468, 59 Sup. Ct. 260, 83 L. Ed. 292;
Sec. 113 (b) (1) (A), **Internal Revenue Code**, 53 Stat. 44;
Sec. 19.113 (b) (1)-1, **Regulations 103**;
Secs. 23.33 and 23.34, **Regulations 104.**

[4]"* * * the income tax laws permit the bank to recoup its capital by deducting from the profits or income the amount of the loss. Thus the bank does not pay a tax on all its income, but on the amount of income less the loss on the worthless debt. The debt itself then loses its nature as capital, but represents that portion of the income which was not taxed, and the capital is the money taken from the profits or income. If the loan, after being deducted from income, is paid, then the lender is receiving profit or income—otherwise the lender would double its capital on one transaction. In other words, the profits or income used to pay back the capital when the debt is charged off is represented by the worthless loan, so that when such loan is paid the profits are replaced."
National Bank of Commerce of Seattle vs. Commissioner of Internal Revenue (C. C. A. 9th Cir., 1940), 115 F. (2d) 875.

[5]The development of similar equitable doctrines with respect to the Federal income tax laws under the terminology of "equitable estoppel," "quasi estoppel," and "election" has been discussed in Maguire & Zimet, Hobson's Choice in Federal Taxation, 48 Harvard Law

No such situation is presented here. The taxpayers derived no tax benefit from the losses listed in 1930 and 1931. No portion of otherwise taxable income was allocated to return of the invested capital, beyond which any further return must be gain. There was no such otherwise taxable income to allot; without the losses in question, there was still a net loss. The government was not deprived of revenue, since even without these losses there was nothing to be taxed. No equitable estoppel can arise. Nor is there any irrevocable election on the part of the taxpayers through mere listing of losses in 1930 and 1931, to have them considered in that year or not at all—since, when the government itself reopens the matter by its demand for taxes on the payments received in 1939, the taxpayers may claim recoupment on the basis of the transaction as a whole.

Bull vs. United States (1934), 295 U. S. 247, 55 Sup. Ct. 695, 79 L. Ed. 1421;

Dixie Margarine Co. vs. Commissioner of Internal Revenue (C. C. A. 6th Cir., 1940), 115 F. (2d) 445.

The principle contended for by the petitioners in these cases originally was adopted by the Commissioner. In G. C. M. 18525, 1937-1 C. B. 82, the Commissioner concluded that where bad debts are charged off and deducted in an income tax return, subsequent recoveries on such bad debts constitute taxable income only where the deduction "accomplished a reduction in tax liability and [previous statements with

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Rev. 1281, 1293, et seq., and 39 Columbia Law Rev. 305. It would appear that the petitioners' factual misrepresentation in 1930 and 1931, i. e., that a loss in a specified amount had been sustained, contains all of the elements of even a technical equitable estoppel where the loss was of tax benefit to them with a single possible exception. That exception is the requirement that the person against whom the estoppel is asserted must have knowledge of the true facts at the time of the misrepresentation. Whether this element is in fact essential to the existence of equitable estoppel or whether some other equitable doctrine is applicable to these cases is immaterial in view of the petitioners' concession.

respect to the taxability of such recoveries] do not refer to deductions for bad debts in cases in which the taxpayer on account of other allowable deductions had no net income, irrespective of the deduction for bad debts." The Commissioner further stated in G. C. M. 20854, 1939-1 C. B. (Part 1) 102:

> "In any case in which a bad debt has been allowed as a deduction and has had the effect of offsetting taxable income (meaning, for present purposes, income which would be the basis for the computation of a tax liability), the taxpayer has, to that extent, in effect had the benefit of a recovery of capital for income tax purposes. In determining the extent, if any, to which a taxpayer has thus benefited, the credits against net income provided in the Revenue Acts must be taken into account. To the extent that a deduction does not result in such a benefit to the taxpayer, the deduction can not be said to have accomplished a return of capital. Until a taxpayer has had the income tax equivalent of a full return of the capital represented by his debt, there is no valid ground for treating as income any amount received in recovery of the debt."

In 1940 the Commissioner reached the contrary conclusion and revoked the above rulings by G. C. M. 22163, 1940-2 C. B. 76. Following this ruling, Congress, in the *Revenue Act of 1942*, Sec. 116 (a), 56 Stat. 812, amended Sec. 22 (b) of the Internal Revenue Code to provide expressly that recoveries of bad debts, prior taxes or other specified items for which deductions were allowed in prior years shall be included in gross income only to the extent that they represent a tax benefit to the taxpayer on returns for prior years.

There is nothing in *United States vs. Ludey* (1927), 274 U. S. 295, 47 Sup. Ct. 608, 71 L. Ed. 1054, opposed to the contentions of the petitioners in this case. That case involved the question as to the propriety of adjustments to basis for depletion and depreciation allowable although not

claimed by the taxpayer. The decision of the Court that the basis must be reduced by the full amount allowable was based on the proposition that depreciation and depletion represent a loss of capital which actually occurs. The Court further held that a taxpayer is not to be permitted to juggle the deduction for depreciation and depletion between various tax years, inasmuch as it occurs ratably during each year. The failure of a taxpayer to claim in its tax returns the full amount of depreciation and depletion allowable represented a failure to take account of the capital then recovered, whereas in these cases the taxpayers recovered nothing in 1930 or 1931 in addition to the sale price of the stock, which sale price was substantially less than the original capital investment.

The decision of this Court in the case of *Virginian Hotel Corporation vs. Helvering* (1943), ... U. S. ..., 87 L. Ed. 1149, ... Sup. Ct. ..., is not opposed to the above contentions and authorities. The question presented by that case was whether in computing depreciation on a straight line basis for the year 1938, the taxpayer was required to reduce the cost of the property by the amount of depreciation referred to in its tax return for prior years, although admittedly the amount thereof was in excess of the amount properly deductible for such prior years and the amount of such *excess* had not served to reduce the tax liability of the taxpayer because other deductions were sufficient to reduce its taxable income to zero. Section 113 (b) (1) (B) of the *Revenue Act of 1938* was applicable to the problem and provided that the cost should be reduced by depreciation "to the extent allowed (but not less than the amount allowable)" during years prior to 1938. This Court in construing the statute held that the quoted phrase did not connote the receipt of a tax benefit but merely required that the deduction be claimed in the taxpayer's returns. The decision

was not based on a determination as to the concept of income but on the narrow issue as to whether Congress in granting a *deduction* from income intended to condition the computation of the particular deduction in the manner claimed by the taxpayer. The Court held that Congress did not intend to provide (and presumably was not required to provide) for a means whereby a taxpayer will be guaranteed that he will recover *through deductions from income* the entire cost of a depreciable asset. This Court has frequently held that the matter of granting deductions depends upon legislative grace. *Deputy vs. DuPont* (1940), 308 U. S. 488, 493, 84 L. Ed. 416, 60 Sup. Ct. 363; *New Colonial Ice Co. vs. Helvering* (1934), 292 U. S. 435, 440, 78 L. Ed. 1348, 54 Sup. Ct. 788. This rule as illustrated by the decisions of this Court cited in support of our contentions has never been extended to questions involving the distinction between capital and income. The existence of taxable income depends upon the existence of *gain* and Congress has not legislated and does not have the power to legislate to the contrary. The exemption of capital receipts from the impact of the income tax is not a matter of legislative grace.

Both dissents in the *Virginian Hotel Corporation* case were based on a disagreement as to the proper construction to be given to the statute involved. Neither the majority nor the dissenting opinions in that case are decisive of the problems here involved, inasmuch as they are both based on a construction of a section of the statute not material to these cases.

In footnote 8 to the decision in the *Virginian Hotel Corporation* case the Court raises the question as to the correctness of the theory that where a return discloses a net loss a particular deduction may be singled out as offsetting gross income, even though it is one of several deductions which are claimed. We believe that the answer to the question is

at once practical and simple. It is obvious that no one can assert that deduction A (deductions other than the loss on sales of National City Bank stock) was used to offset gross income, and deduction B (the loss on sale of National City Bank stock) was not so used where a net loss in excess of either deduction results from both deductions, but a net income would result if both were eliminated as deductions. It seems equally obvious that this fact is immaterial under the theory which forms the basis for our contentions. This theory is that the recoveries here involved are recoveries of capital and cannot be taxed unless for some reason based on valuable benefits previously received by the taxpayer and corresponding detriments suffered by the Government the taxpayer is prevented from asserting the capital nature of the recoveries. One of the universally recognized elements of any form of equitable estoppel is that the person asserting the estoppel has suffered some loss or damage. *Maguire & Zimet,* Hobson's Choice in Federal Taxation, 48 Harvard Law Review 1281, 1293; *et seq.; Pomeroy's Equity Jurisprudence,* Fourth Edition, Paragraphs 804, 805 and 812; *Lansing McVickar* (1938), 37 B. T. A. 758, 761. The Government clearly suffered no loss or damage as a result of the fact that the taxpayers claimed losses in their 1930 and 1931 returns, inasmuch as the elimination of these losses (to the extent of the 1939 recoveries claimed to be nontaxable) would not have resulted in any tax liability for those years. The fact that if such losses had been eliminated *and* if other deductions had also been eliminated a tax liability for 1930 or 1931 would have existed, does not create the necessary element of loss or damage to the Government. None of the deductions other than the losses on sales of National City Bank stock were questioned upon audit of the 1930 and 1931 returns or in this proceeding. To find loss or damage to the Government sufficient to support an

estoppel by reason of the fact that at some time in the future these other deductions conceivably may be questioned would represent a highly inequitable application of an equitable doctrine. See *Maguire & Zimet,* Hobson's Choice in Federal Taxation, 48 Harvard Law Review 1281, 1315, and *Pomeroy's Equity Jurisprudence,* Fourth Edition, Paragraph 813.

One other answer to the problem raised by this Court in footnote 8 of its decision in the *Virginian Hotel Corporation* case has been suggested by the court in *Philadelphia National Bank vs. Rothensies* (D. C. Pa., 1942), 43 Fed. Supp. 923. The court there held that the burden of proving an estoppel against the right of the taxpayer to assert the capital nature of a recovery is upon the Government and that, therefore, the Commissioner must show (as applied to the facts of our case) that losses in 1930 or 1931 upon sale of National City Bank stock, as distinguished from other deductions claimed and allowed in returns for such years, did in fact result in a tax saving to the taxpayer. The Commissioner has not sustained such a burden in these cases.

The above contentions lead to consideration of the application of the rule in situations in which two capital recoveries are made in successive years, e. g., 1939 and 1940, with respect to separate transactions, both of which resulted in deductible losses for a single prior taxable year, e. g., 1930. Treatment of the capital recovery during 1939 in such a case would be no different than that proposed by the taxpayers in these cases. However, in determining the treatment of the capital recovery in 1940, the Commissioner would be able to assert an estoppel based on the reduction in tax liability for 1939, assuming that the adjustments made in the 1930 tax return by reason of the 1939 recovery had sufficiently eliminated the net loss for 1930 so that further adjustments would produce tax liability for 1930. There is little to be gained by further discussion of such

involved fact situations, but the above example demonstrates that the petitioners' theory is sufficiently flexible to meet any similar problem likely to arise.

The Commissioner has conceded that John V. Dobson is not prevented from asserting the capital nature of the recovery in 1939 under facts which are similar to those here involved in so far as the problem discussed immediately above is concerned. John V. Dobson sold 200 shares of stock at a loss of $1,700 in 1931, which loss was deductible in his tax return for that year but was not claimed in his return nor allowed on audit (R. 105). Had the loss been claimed, a tax saving for 1931 would have resulted. In 1939 John V. Dobson recovered $952 of this loss through an action instituted against National City Company. The Commissioner conceded before the Board and the Board held that this recovery did not constitute taxable income (R. 110). If, as the Commissioner concedes, the taxpayer is permitted to assert the capital nature of the recovery in such a case, it follows that the mere fact that a loss was referred to in the 1930 or 1931 tax returns should not be held to constitute sufficient valuable benefits to the taxpayer and detriment to the Government to prevent the taxpayer from asserting the capital nature of subsequent recoveries attributable to transactions giving rise to such losses. There is no greater legal or practical difficulty in separating deductions A and B where both are claimed in the return than in separating deductions A and B when deduction B, through inadvertence or otherwise, is not claimed in the return. The fact that the Commissioner found it legally or administratively desirable to make the above concession in the John V. Dobson case demonstrates the fundamental error in his position before this Court.

III.

The Recoveries Realized by John V. Dobson and Harwick Were in Whole or in Part Within the Above Rule, Even Though After Deduction for the Entire Losses Sustained Upon the Sales in 1930 and 1931 a Statutory "Net Income" Remains But Where All Tax Was Eliminated by Statutory Credits Against "Net Income."

As a result of sales of the bank stock in 1931 Harwick sustained losses of $34,451.28 and claimed this deduction in his 1931 income tax return. That return disclosed statutory "net income" of $12,042.03 but also disclosed the following statutory credits against or deductions from "net income":

Dividends	$11,861.81
Personal exemption	3,500.00
Credit for dependents	800.00
	$16,161.81

These credits, plus a credit against the *tax* designated by the *Revenue Act of 1938* as an "earned income credit," eliminated all tax liability on the return and would also have eliminated all tax liability had the loss on sale of National City Bank stock actually been $7,115.78 less than the amount claimed and allowed in 1931 (R. 10-12).

In view of the above facts, Harwick asserts (as to a small extent under similar facts does John V. Dobson) that he received no valuable benefits from his loss in 1931 and the Government sustained no loss of revenue therefrom which prevent him from asserting that $7,115.78 of his recovery out of a total recovery of $17,000 in 1939 was a recovery of capital. The Board of Tax Appeals, although accepting the general contentions of the other taxpayers, refused to accept this analysis of the problem and held that to the extent that

the recovery in 1939 when added back to the 1930 or 1931 losses produced a statutory "net income" such recoveries were taxable income. In the Harwick case, inasmuch as the original return disclosed a statutory net income, the Board held that the entire recovery in 1939 was taxable. Because the Circuit Court of Appeals reversed the Board on the general issue, it was not necessary for that Court to consider this problem and it did not do so.

It is the contention of Harwick and John V. Dobson (1) that in determining valuable benefits received by the taxpayer and detriment sustained by the Government under the theory advanced in part I above the sole consideration which has any reality is whether any reduction in tax liability resulted, and (2) that the statutory concept of "net income" is so arbitrary as to be of no value in a problem such as this. If our theory is sound, the first contention is sufficient to support Harwick's and John V. Dobson's position. Congress has recently adopted this theory with respect to recoveries on bad debts previously charged off. Section 116 of the *Revenue Act of 1942*, 56 Stat. 812, provides in part that recoveries on bad debts previously charged off are not income if and to the extent that the previous chargeoff did not "result in a reduction of the taxpayer's tax." The report of the Senate Finance Committee on this section, page 80, Report No. 1631, states that:

> "In determining whether and to what extent the deductions and credits on account of bad debts, taxes and delinquent amounts allowed in a given year did not result in a tax benefit, such deductions and credits are to be regarded as having been the last ones taken and those as having off-set such *gross income or tax as was not off-set by the other deductions or credits.*" (Italics added.)

It is apparent from the above provisions of Section 126 and the Senate Finance Committee report that Congress has

adopted the test as to "tax benefit" which is here urged by Harwick and John V. Dobson. Inasmuch as we understand that this amendment was a Treasury proposal, it no longer is open to the Commissioner to argue as he did before the Board and the Circuit Court of Appeals that the taxpayers' test as to tax benefit is too complicated and unworkable. We, therefore, submit that the same sound reasons which prompted Congress and the Treasury to establish this particular test as to tax benefit should govern this Court in deciding these cases.

The second contention with respect to the arbitrary basis of the statutory concept of net income requires an analysis of the *Revenue Act of 1928*, 45 Stat. 791, *et seq.* Under the Revenue Act of 1928, as under all Revenue Acts, the "net income" of a taxpayer is determined by rather specific and arbitrary statutory provisions. Section 21 defined "net income" as the gross income computed under Section 22 less the deductions allowed by Section 23. Both the normal tax on individuals imposed by Section 11 and the surtax imposed by Section 12 are imposed on "net income." However, Section 25 cuts across these provisions and requires a somewhat different result from that which would otherwise be required by a literal construction of Sections 11, 12, 21, 22, and 23. Section 25 allows as "credits against the net income" for normal tax purposes dividends received from domestic corporations, a personal credit of $3,500 for a married person, and a credit of $400 for each dependent. It is obvious from this review of the statutory provisions that two "net incomes" are provided for by the statute, viz., the net income which is defined in Section 21 and the "net income" to which the taxes under Sections 11 and 12 are applied. The earned income credit which is deducted from both normal and surtax, which would otherwise be payable, is provided for by Section 31 and is determined by reference to

the earned income of the taxpayer as distinguished from income from investments.

The above provisions are the only ones which affected the determination of the tax liability of the taxpayers Harwick and John V. Dobson for 1930 or 1931. However, numerous other provisions of the *Revenue Act of 1928* could affect the computation of net income and of tax. For example: Section 101 provides for the elimination of capital gains and losses from the "net income" subject to tax under Sections 11 and 12 in certain cases and the imposition of a separate tax. Section 116 provides that certain items normally within the concept of net income shall be excluded from gross income under Section 22. Section 115 excludes from gross income dividends paid by corporations out of pre-March 1, 1913, surplus. On the deduction side, after computation of "net income," Section 117 provides for the deduction under certain circumstances of losses sustained in previous years; Section 118 disallows so-called "wash-sale losses"; and Section 120 provides that the limitations on the deductions for contributions, which Section 23 sets at 15 per cent of net income before the deduction for contributions, shall not apply where the contributions are so substantial as to meet certain statutory requirements.

The above resumé of some of the provisions of the *Revenue Act of 1928* is intended to indicate the arbitrary nature of the term "net income" as used in that Act and the fact that a variety of definitions for that term can be evolved under different sections of the statute. Furthermore, the concept of "net income" has changed in the various Revenue Acts. For example: Certain corporate distributions which are not included in net income under the *Revenue Act of 1928* are included in net income under the *Revenue Act of 1936* (see Section 115, *Revenue Act of 1936*, 49 Stat. 1687) and interest on Federal bonds was not subject to tax under the Rev-

enue Act of 1928 but such interest on bonds issued since March 1, 1941, now is fully taxable. See Section 22, *Internal Revenue Code,* 53 Stat. 10, and Section 4, *Public Debt Act of 1941,* 55 Stat. 9.

IV.

The Portion of the Recovery From National City Company Which the Taxpayer Concedes in the Harwick Case or Which This Court (Contrary to Taxpayers' Contentions) May Hold in the Other Cases Is Taxable Income for 1939, Is Properly Taxable as "Long-Term Capital Gain" Under Section 117 of the Internal Revenue Code and Therefore Only Fifty Per Cent Thereof Is to Be Subjected to Tax.

Both the Board and the Circuit Court of Appeals concluded that, to the extent that the amounts received by the taxpayers from National City Company constituted taxable income, they were to be treated as ordinary income and not as long-term capital gains under Section 117 of the *Internal Revenue Code,* 53 Stat. 50.

Section 117 provides that when income is properly classified as long-term capital gain only fifty per cent thereof is to be taxed instead of taxing the entire gain as in the case of other income. Subdivision (a) (4) of Section 117 defines long-term capital gain as follows:

> "The term 'long-term capital gain' means gain from the sale or exchange of a capital asset held for more than 18 months, if and to the extent such gain is taken into account in computing net income."

It is not disputed that, to the extent the taxpayers realized taxable income, if any, from the recoveries here involved, such income was realized upon disposition of a capital asset and we believe that the Commissioner will concede that the capital asset was held more than 18 months. The sole ques-

tion to be decided, therefore, is whether the capital asset, upon which the gain was realized, was disposed of by the taxpayer in a "sale or exchange." It is the taxpayers' contention that whatever taxable income was realized as the result of a recovery from National City Company in 1939 was realized from a "sale or exchange" and therefore is taxable as capital gain. The determination of this issue requires an inquiry into the nature of the transaction which resulted in the recovery. As previously pointed out in this brief, the taxpayers' claims against National City Company were based on the right to rescind the purchases and secure a refund of the purchase price. It also is admitted by the Commissioner (R. 62) that where a taxpayer continued to hold his National City Bank of New York stock, the recovery in 1939 attributable to such stock was not taxable. It follows, therefore, that the receipt of income in 1939 (to whatever extent taxable) represented "gain from the sale" of the stock *in 1931* which was not taxable until 1939, at which time it was received by a cash basis taxpayer. The quoted phrase is from Section 117 of the Internal Revenue Code and it is submitted that it accurately describes the source of whatever gain may be deemed taxable in this case. It seems clear that even under the Commissioner's theory the taxable income was not "from" the recovery in 1939 because, unless there was a prior sale of the stock, there is no taxable income as the result of that recovery. The gain then must be "from" the sale of the stock in 1931. Although the Commissioner and the taxpayer may differ as to whether the 1931 sale caused part or all of such "gain" realized in 1939 to be taxable merely because the loss was claimed in 1931 or because the loss was of tax benefit in that year, we seem to be agreed that it was the 1931 sale which gives part or all of this 1939 recovery its character as taxable income, if it has that character at all. The mere fact that the gain was received and

taxed in a year long after 1931 should not prevent it from taking its character as capital gain from the events in 1931. A common example of a similar situation is found in the taxation of gain on installment sales under Section 44 of the *Internal Revenue Code,* 53 Stat. 24. Gains under this section are taxed in proportion to the amount received in years subsequent to the year of sale and such gains are classified as capital or ordinary gain pursuant to the law applicable to the year in which the gain is received. *Snell vs. Commissioner* (1938, C. C. A. 5), 97 Fed. (2d) 891.

The Circuit Court of Appeals rejected the above contentions of the taxpayers because (R. 135) "there was no causal relation between the sales in former years and the recoveries in the latter * * *. The sales of stock were completed transactions in 1930 and 1931 and they can neither in fact nor in law be coupled with a settlement in 1939 so as to transform the two transactions into a single sale or exchange of capital assets." Despite the above statement, the Commissioner and the Court found sufficient "causal relation" between the sales in 1930 and 1931 and the recoveries in 1939 to hold such recoveries constituted taxable income if, *and only if,* the recoveries were made with respect to stock which was *sold* in 1930 and 1931. Thereby the Commissioner and the Court "in fact and in law" coupled the sales in 1930 and 1931 with the recoveries in 1939. The meaning of words is often elusive but we submit that the quoted statement of the Court is clearly erroneous.

CONCLUSION

It is respectfully submitted, therefore, that this Court should hold James N. Collins, E. W. Dobson, John V. Dobson, and H. J. Harwick were taxable on no part of the recoveries realized in 1939 as a result of suits against National City Company which the Commissioner has added to their income. It is further submitted that this Court should hold that the portion of the recovery in 1939, which H. J. Harwick concedes to be taxable income, should be taxed as capital gain under Section 117 of the Internal Revenue Code rather than as ordinary income. For these reasons petitioners pray that the judgments of the United States Circuit Court of Appeals for the Eighth Circuit reversing the judgments of the United States Board of Tax Appeals be themselves reversed, and that the portions of the judgments of the United States Board of Tax Appeals questioned by the appeals therefrom taken by H. J. Harwick and John V. Dobson also be reversed.

Respectfully submitted,

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APPENDIX A

Facts involved in E. W. Dobson vs. Guy T. Helvering, Commissioner of Internal Revenue, No. 45, R. 80-83.

At various times in 1928, 1929, and 1931 E. W. Dobson purchased a total of 600 shares of the capital stock of the National City Bank of New York. The purchases were made in the State of Minnesota from the National City Company.

In 1929 E. W. Dobson sold 200 shares of the stock which had cost him $76,350 for $74,000, thereby sustaining a loss of $2,350. This loss was not claimed as a deduction in his 1929 income tax return because of the wash-sales provisions of the Revenue Act of 1928, and it would not have been allowed if it had been claimed.

In 1930 he sold 200 shares of the stock which had cost him $70,000 for $20,697.44, thereby sustaining a loss in the amount of $49,302.56, which loss was claimed as a deduction in his return for 1930. Although the deductible loss actually sustained on this sale was $2,350 greater than that claimed by the petitioner in his return, because of the increased basis resulting from the 1929 wash-sale, the deduction actually claimed by petitioner in his return of 1930 was not disturbed by the respondent because the return showed a net loss.

In 1931 he sold the remaining 200 shares of the stock which had cost him $17,700 for $16,000, thereby sustaining a deductible loss for income tax purposes in the amount of $1,700. This loss was claimed by him as a deduction from gross income in his return for 1931 and was allowed as a deduction by the Commissioner.

The suit by E. W. Dobson against National City for rescission of these purchases was settled in 1939 by a net payment of $32,384.80 by the company to E. W. Dobson, and upon receipt thereof the suit was dismissed with prejudice

pursuant to a stipulation between the parties. Of the total net recovery, $31,432.80 is allocable to the stock sold in 1930 and the balance of $952 is allocable to the stock sold in 1931. It is conceded that the last amount mentioned constituted taxable income for the year 1939 and was reported as income in his return for that year.

Of the deduction of $49,302.56, which was claimed and allowed on E. W. Dobson's 1930 income tax return, $5,983.51 thereof is attributable to 40 shares of stock which had been purchased in 1928 and none of the recovery in 1939 was attributable to such loss. If the balance of the deduction, $43,319.05, had been disallowed, no deficiency in income tax liability for 1930 would have resulted, as shown by the following computation:

Net loss per return		($30,197.56)
Add loss claimed on sale of National City Bank stock with respect to which E. W. Dobson made a recovery in 1939		43,319.05
Net income revised		13,121.49
Less:		
Dividends	$13,130.50	
Personal exemption	00.00	
Credit for dependents	00.00	
Total		13,130.60
Balance subject to normal tax		None
Normal tax: 1½% on first $4,000		None
Surtax on $13,121.49		31.21
Less earned income credit		39.25
Total tax assessable		None

If E. W. Dobson had received $31,432.80 on the sale of the stock in 1930, in addition to the amount actually received on such sale, the said $31,432.80 being the amount actually recovered in respect of such stock by reason of the settlement in 1939, his 1930 loss on the sale of the stock would

have been $20,219.76, and he would have had no income tax liability for that year, as shown by the following computation:

Net income as shown in original return		($30,197.56)
Add: Entire amount recovered in 1939 in reduction of loss on stock sold in 1930		31,432.80
Net income revised		1,235.24
Less:		
Dividends	$13,130.60	
Personal exemption	00.00	
Total		13,130.60
Balance subject to normal tax		None
Total tax assessable		None
Tax assessed		None
Deficiency		None

Throughout the year 1939 adjustment of E. W. Dobson's income tax liability for 1930 was barred by the Statute of Limitations.

In his income tax return for 1939, E. W. Dobson reported income of only $952 on account of the recovery of $32,384.80. In the deficiency notice the Commissioner adjusted the amount of gross income reported by adding thereto $31,432.80, thereby treating the entire amount of the net recovery of $32,384.80 as gross income.

The Board of Tax Appeals held that because the amount of the loss reported in the 1930 return of E. W. Dobson, viz., $30,197.56, increased by the loss not claimed, viz., $2,350, was in excess of the amount recovered in 1939 attributable to the stock sold in 1930, viz., $31,432.80, E. W. Dobson was not taxable on any portion of such recovery, but the entire amount constituted a recovery of the capital (R. 83).

Facts involved in John V. Dobson vs. Guy T. Helvering, Commissioner of Internal Revenue, No. 44, R. 105-109.

At various times in 1929 John V. Dobson purchased, in transactions entered into for profit, a total of 440 shares of the capital stock of the National City Bank of New York. The purchases were made in the State of Minnesota from the National City Company.

During the year 1929 John V. Dobson sold a total of 240 shares of the stock, 90 shares of which resulted in a taxable gain of $8,168.44 and was so treated in closing his income tax liability for 1929. The sale of the remaining 150 shares in 1929 resulted in a loss of $13,168.44, properly disallowed as a deduction in closing his 1929 income tax liability because of the wash sales provisions of the Revenue Act of 1928.

In 1930, John V. Dobson sold the remaining 200 shares of the stock for $20,897.44. These shares had actually cost $70,000, but, because of the wash sales in 1929 which resulted in nondeductible losses for that year, the basis for determining the amount of loss sustained in 1930 was $70,000, plus $13,168.44, or $83,168.44. The 1930 sale resulted in a deductible loss in the amount of $62,271, which was allowed by the Commissioner as a deduction in closing John V. Dobson's income tax liability for that year.

On July 3, 1931, John V. Dobson purchased 200 shares of the bank stock at a cost of $17,700, and on July 13, 1931, sold the said shares for $16,000, thereby sustaining a loss of $1,700, which was deductible for 1931, but was not claimed as a deduction. Upon audit of the return, no deduction was allowed by the Commissioner by reason of the loss realized on the sale, but had such loss been claimed as a deduction it would have been allowed and would have reduced the income tax liability of John V. Dobson for the year 1931, but

would not have eliminated entirely liability to tax. His 1931 return disclosed net income of $17,514.27, and a tax thereon of $125.43, which was paid to the Collector during the year 1932.

The suit of John V. Dobson against National City Company for rescission of these purchases was settled in 1939 by a net payment of $33,404 by the company, and upon receipt thereof the suit was dismissed, with prejudice, pursuant to a stipulation between the parties. Of the total net recovery, $157.04 related to 40 shares of stock which are not here involved and is conceded to be taxable income. Of the remainder, $32,294.95 is allocable to the stock sold in 1930 and the balance of $952 is allocable to the stock sold in 1931. The Commissioner concedes that this latter amount does not constitute income taxable to John V. Dobson in 1939.

If the entire deduction of $62,271, allowed as a deduction in connection with John V. Dobson's 1930 Federal income tax liability had been disallowed, there would have been net income in the amount of $32,227.53 and a deficiency in income tax for 1930 would have resulted in the amount of $1,232.75, computed as follows:

Net loss		($30,043.47)
Add: Loss on National City Bank stock, eliminated		62,271.00
Net income revised		32,227.53
Less:		
Dividends	$23,659.45	
Personal exemption	3,500.00	
Credits for dependents	1,200.00	28,359.45
		3,868.08
Normal tax: 1½% of $3,868.04		$ 57.02
Surtax on $32,227.53		1,240.48
Total		1,297.50

Total (Carried over)	$ 1,297.50
Less: Earned income credit	64.75
Total tax assessable	1,232.75
Assessed	0.00
Deficiency	1,232.75

If in addition to the $20,897.44 actually received on the sale of the stock in 1930 John V. Dobson had received $32,294.96, being the amount recovered in 1939 in respect of the stock sold in 1930, his deductible loss for 1930 from the sale of the said stock would have been $29,976.04 and he would have had net income in the amount of $2,251.49. Due to certain credits allowable, however, his income tax for 1930 would have been zero, shown as follows:

Net Loss		($30,043.47)
Add: Entire amount recovered in 1939 in reduction of loss on stock sold in 1930		32,294.96
Net income revised		2,251.49
Less:		
Personal exemption	$3,500.00	
Credit for dependents	1,200.00	
Total		4,700.00
Balance subject to tax		None
Total tax assessable		None
Tax assessed		None
Deficiency		None

Throughout the year 1939 adjustment of John V. Dobson's income tax liability for 1930 was barred by the Statute of Limitations.

In his income tax return for 1939 John V. Dobson reported income of only $157.04 on account of the recovery of $33,404. In the deficiency notice the Commissioner adjusted

the amount of gross income reported by adding $33,246.96 and thereby treating the entire amount of the net recovery of $33,404 as ordinary income.

The Board of Tax Appeals held that because the amount of loss reported in John V. Dobson's 1930 income tax return, viz., $30,043.47, was $2,251.49 less than the amount of the recovery attributable to the 1930 sales, viz., $32,294.96, he was taxable on $2,251.49 of such recovery, and that said amount was taxable as ordinary income rather than as capital gain under Section 117 of the Internal Revenue Code. The Board also held that John V. Dobson was not taxable on that portion of the recovery attributable to the sales in 1931, viz.: $952, inasmuch as this amount was less than the loss sustained on such sale, viz.: $1,700, and said loss had not been claimed or allowed as a deduction in John V. Dobson's 1931 income tax return.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1943

No. 44

JOHN V. DOBSON,

Petitioner,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

No. 45

E. W. DOBSON,

Petitioner,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

No. 46

ESTATE OF JAMES N. COLLINS, DECEASED, FIRST NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, EXECUTOR,

Petitioner,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

No. 47

H. J. HARWICK,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

REPLY BRIEF FOR PETITIONERS

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COMMISSIONER OF INTERNAL REVENUE.

REPLY BRIEF FOR PETITIONERS

The briefs submitted in this case are in direct conflict upon a fundamental question of the greatest importance in the basic tax law of the United States. That question is:

May Congress, by resorting to a method of annual tax accounting, transform a return of invested capital, not taxable under the Sixteenth Amendment, into income which is taxable?

It is undisputed that the taxpayers in this case invested their capital in stock of the National City Bank; that they realized a partial recovery of that capital through resale of the stock; and that the payments made to them in 1939, which are now in question, represented a return of a part of their purchase money in rescission of the purchase. It is not disputed that this recovery in 1939 was still partial and incomplete, and that as a matter of economic reality and hard fact the taxpayers have not yet recovered their capital investment, and not only have gained nothing but are still out of pocket on the transaction. It is the contention of the Government that Congress, by requiring an accounting in the year of the resale of the stock, can change the nature of the later recovery of invested capital so that it becomes taxable income; and that Congress has done so. It is the contention of the taxpayers that Congress has no power either to tax a return of invested capital or to create taxable income by accounting devices; and that Congress has not done so. Upon this fundamental issue, we believe that the case must be decided.

The case for the taxpayers of course rests upon *Eisner vs. Macomber* (1920), 252 U. S. 189, 40 Sup. Ct. 189, 64 L. Ed. 521; *Bowers vs. Kerbaugh-Empire Co.* (1926), 271 U. S. 170, 46 Sup. Ct. 449, 70 L. Ed. 886; *Doyle vs. Mitchell* (1918),

247 U. S. 179, 38 Sup. Ct. 467, 62 L. Ed. 1054, and other cases (listed at page 15 of our original Brief) holding that where capital has been invested there can be no income arising out of any reimbursement until that capital has first been restored in full. This apparently is not disputed by the Government. Instead, it is contended that Congress, or the Treasury by Regulations, may set up an accounting procedure by which that capital is deemed to be restored in full when it has not in fact been restored, so that there is thenceforth a "basis of zero for determining gain or loss" (Br. 7) as to the reimbursement. It is the admitted fact that in reality the capital was not restored, and has not yet been restored; but by a fiction it is to be called restored, and upon that fiction there is founded a "basis" for treating a partial restoration as income.

In support of this position, the Government advances various arguments, as follows:

1. The contention that capital gains and losses must be computed on the basis of an annual accounting for each single taxable year.

The Government argues that "Gain or loss is properly ascertained on the basis of a fixed annual accounting period, and income computed annually as the net result of all transactions within the year is properly taxable although there may have been a loss on the overall transaction" (Br. 18), and seeks to apply this proposition to a transaction involving a restoration of invested capital. In support of this argument, reliance is placed upon *Burnet vs. Sanford & Brooks Co.* (1931), 282 U. S. 359, 51 Sup. Ct. 150, 75 L. Ed. 383, where the single-year accounting theory was held to be properly applied to operating expenditures in the performance of a dredging contract, followed by recovery of additional compensation under the contract. The case turns

upon the following language of the Court, at page 363:

> "The money received was derived from a contract entered into in the course of respondent's business operations for profit. While it equalled, and in a loose sense was a return of, expenditures made in performing the contract, still, as the Board of Tax Appeals found, the expenditures were made in defraying the expenses incurred in the prosecution of the work under the contract, for the purpose of earning profits. *They were not capital investments, the cost of which, if converted, must first be restored from the proceeds before there is a capital gain taxable as income.* See *Doyle vs. Mitchell Brothers Co., supra*, page 185 of 247 U. S., 38 Sup. Ct. 467." (Italics supplied.)

The Government interprets the italicized words as meaning merely that if these had been capital expenditures they would properly have been added to basis when made rather than being deducted as a business expense (Br. 19). But this interpretation is not borne out by the record in the case. The decision reversed *Sanford & Brooks Co. vs. Commissioner of Internal Revenue* (C. C. A. 4th Cir., 1929), 35 F. (2d) 312, in which Judge Parker, in holding that the recovery involved was not income, had treated it as a reimbursement of capital outlay, and had said (at page 313):

> "It is said, however, that each year must be treated as a unit for income tax purposes, and that for this purpose we must view the expenditures and collections of each year entirely apart from those of other years. It is undoubtedly true that the year is the unit in income taxation and that income received or accrued within a given year must be reported as of that year; but it by no means follows that the events of other years may not be considered along with a particular item of alleged income in determining whether it constitutes taxable income or mere reimbursement of loss."

It seems clear that the italicized language quoted above was directed to this position of Judge Parker, and that it was written in response to a similar contention in the brief of

the taxpayer filed in the case (Respondent's Brief in *Burnet vs. Sanford & Brooks Co.* (1931), 282 U. S. 359, 51 Sup. Ct. 150, 75 L. Ed. 383, at pages 5-11. See also Brief of *Amici Curiae,* at pages 6-9). It was, as a matter of fact, an adoption of the position taken at that season by the Government, as set forth in its petition for certiorari:

> "The case of *Bowers vs. Kerbaugh-Empire Co.*, 271 U. S. 170, relied upon by the Circuit Court of Appeals, is distinguishable on the facts. In the instant case there was a transaction arising out of the operation of a business where compensation was collected for work performed in earlier years, the expenditures made in performing the work having been properly deducted in those years. In the *Kerbaugh-Empire Co. case* the whole transaction was a capital transaction."
>
> (Petition for Writ of Certiorari, in *Burnet vs. Sanford & Brooks Co., supra,* at page 17.)

To the same effect is the Government's own interpretation of the case after it was decided, found in G. C. M. 22163, 1940-2 C. B. 76, at page 79:

> "Under the principle of the Supreme Court's decision in the Sanford & Brooks Co. case, *supra,* items of expense incurred in carrying on a trade or business do not represent capital investment, the cost of which, if converted, must first be restored before there is a capital gain taxable as income,"

and likewise the interpretation of the Circuit Court of Appeals for the Fourth Circuit in *Commissioner of Internal Revenue vs. Norfolk Southern R. Co.* (C. C. A. 4th Cir., 1933), 63 F. (2d) 304, at page 306:

> "In *Burnet vs. Sanford & Brooks Co.,* the Supreme Court was dealing with a sum received by a contractor in a particular year, as a result of litigation, to recompense it for a loss sustained in an earlier year. The amount so received was held income for the year in which received on the principle that the whole business was a continuing one engaged in for profit; and the distinction was clearly made between ordinary income from

the business and the depletion of capital used in the business."

The same history disposes of the contention of the Government (Br. 19, note) that the decision in the *Sanford & Brooks Co. case* in some way overruled or disapproved *Bowers vs. Kerbaugh-Empire Co., supra,* which has since been cited for the very point on which it is contended that it was overruled.

United States vs. Kirby Lumber Co. (1931), 284 U. S. 1, 3, 52 Sup. Ct. 4, 76 L. Ed. 131;

Helvering vs. American Chicle Co. (1934), 291 U. S. 426, 54 Sup. Ct. 460, 78 L. Ed. 891.

The Government confesses inability to perceive any "logical basis or practical reason" for the distinction, as to single-year accounting, between operating expenses and income on the one hand, and capital investment and return on the other (Br. 18). If the Sixteenth Amendment had conferred upon Congress the power to tax capital, or the restoration of capital, without apportionment, there would indeed be no basis or reason for any such distinction. But once it is conceded, as it must be conceded, that there is no power to tax the mere return of invested capital, unaccompanied by any gain, it follows that such a return can no more be taxed through the device of single-year, or single-month, accounting, than by a statute declaring in so many words a levy upon the capital thus restored. This we believe to be the plain significance of the distinction made in *Burnet vs. Sanford & Brooks Co., supra.*

Nor is there any indication that Congress has displayed any intention of taxing such a capital return as this. The Government recognizes (Br. 12) that the repayments to the taxpayers in 1939 were in exchange for the surrender of a right of rescission, which was itself a property interest, and which was neither sold nor extinguished in the prior years.

The argument (Br. 10-13) that upon the sale or disposition of such an interest the statute requires that adjustment be made for past deductions which have not in fact restored capital, turns upon the definition of "Adjusted Basis" in Section 113 (b) (1) (set forth in the Government's Brief, at pages 11, 36), which is

> "(1) . . . *Proper* adjustment in respect of the property shall in all cases be made—
>
> (A) For expenditures, receipts, *losses,* or other items, *properly chargeable to capital account,* including taxes and other carrying charges on unimproved and unproductive real property, but no such adjustment shall be made for taxes or other carrying charges for which deductions have been taken by the taxpayer in determining net income for the taxable year or prior taxable years." (Italics supplied.)

In the light of the italicized words, the Government's argument from the statute merely begs the question. Whether the paper loss deducted in the prior year, which did not in fact restore capital, is "properly chargeable to capital account" is what we now seek to determine. It is not to be presumed that Congress had any such intention.

> "In the interpretation of statutes levying taxes it is the established rule not to extend their provisions by implication, beyond the clear import of the language used, or to enlarge their operation so as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the government and in favor of the citizen."
>
> *Gould vs. Gould* (1917), 245 U. S. 151, 153, 38 Sup. Ct. 53, 62 L. Ed. 211.

And in any case, it is of course fundamental that Congress, by enacting any statutory provision whatever, cannot confer upon itself the power to tax a return of capital if that power does not otherwise exist under the Sixteenth Amendment.

2. The contention that the opportunity afforded to deduct the loss upon sale of the stock is the equivalent of a restoration of capital.

When the taxpayers sold their stock of the National City Bank in the prior years, they were permitted by the statute then in force to deduct the full amount of the difference between purchase price and resale price, even though, as events subsquently proved, they had still a right of rescission of the purchase which had value. If that deduction had resulted in the allocation of otherwise tax-free income to restoration of the capital loss, it is conceded that subsequent recovery would have been income, as in *Griffiths vs. Commissioner* (1939), 308 U. S. 355, 60 Sup. Ct. 277, 84 L. Ed. 319. In fact, however, no such restoration occurred, for there was no tax-free income to be allocated in the years in question. In truth, in economic reality and in practical effect, the deduction was a paper one only. The loss was "deducted" from a residue of nothing.

It is contended, however (Br. 9-16), that the mere affording of an opportunity to make this paper deduction of a loss from zero restored the taxpayer's invested capital, so that a later actual restoration becomes gain. "The right to a deduction for loss of capital is treated as the equivalent, for tax purposes, of a prior capital return in computing the gain realized upon subsequent disposition of the remaining property interest" (Br. 11-12). Before the Board of Tax Appeals the Government assumed (R. 110) that where, in the case of the taxpayer, John V. Dobson, the deduction was not even listed on paper, a subsequent recovery was not taxable as income. As the implications of this concession become apparent, it is now withdrawn, and the Government contends (Br. 16, note) that the subsequent recovery is taxable even though the deduction never was listed at all. Bald-

ly stated, the theoretical "opportunity" to claim a deduction, even if there were no income from which to deduct it, is declared to be a return of the investment, beyond which any actual return is gain. We respectfully suggest that the only name for this is bare-faced fiction.

What if, in the case at bar, the stock purchased had been resold on December 31, 1930, and on January 1, 1931, the taxpayer had made claim of fraud, and on that day had received repayment of a part of his purchase money, leaving him still with a loss? It must follow from the Government's contentions that the naked possibility of claiming a deduction for the year 1930, even with no income from which to deduct it, restores the invested capital in its entirety, and transforms the loss into gain. We do not believe that either Congress or the Treasury can confer upon itself, by such a transparent accounting device, the power to tax as gain what is not gain in fact.

The Government professes to find authority for its position in *United States vs. Ludey* (1927), 274 U. S. 295, 47 Sup. Ct. 608, 71 L. Ed. 1054. That case arose out of the sale of oil land, oil leases, and mining equipment. In determining gain or loss on the sale, it was held that there must be subtracted from original cost the full allowable depreciation and depletion of the property over a period of years, even though the taxpayer had claimed only part of it in his income tax returns. Depreciation and depletion had in fact occurred; it was not disputed that the assets had in fact been wasted.[1] The question before the Court was one of how the

[1]The statute involved permitted deduction only where there was in fact depreciation or depletion. It is set out in the case, at page 298, as follows:

"Fourth. Losses actually sustained during the year, incurred in his business or trade. * * *

"Seventh. A reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade;

"Eighth. (a) In the case of oil and gas wells a reasonable allowance for actual reduction in flow and production. * * * (b) in the case of mines a reasonable allowance for depletion thereof. * * *"

amount of it should be determined. The Bureau had estimated an actual depletion and depreciation in excess of the aggregate deductions allowable under the statute, and there was no dispute of fact concerning the correctness of these estimates.[2] The conclusion was that the gain or loss realized on the sale of the property was not dependent upon the taxpayer's prior income tax returns, which might be rectified if they were in error.[3] Rather the amount to be subtracted from original cost as a basis for determining gain or loss must be, subject to the limits of the statutory aggregate,[4] the depreciation and depletion in fact sustained.

With respect to the *Ludey case,* it must be pointed out, first, that it decided that gain or loss in a capital transaction is to be determined on the basis of the completed transaction, and that the income tax returns for any individual year are not controlling. That is of course what the taxpayers are contending in the case at bar. Far from sustain-

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2"For the purpose of determining the cost of the properties sold in 1917 the Commissioner deducted from the original cost $10,465.16 on account of depreciation of the equipment through wear and tear, and $32,258.81 on account of depletion of the reserves through the taking out of oil by the plaintiff, after March 1, 1913. There was no dispute of fact concerning the correctness of the estimates upon which these deductions were made. The finding of the depletion was in accordance with the method of computation employed by the Bureau of Internal Revenue; and there was no objection specifically to the method of computation. * * * The finding of the depreciation was, likewise, in accordance with the method of computation employed by the Bureau; and there was no objection to the method of computation." **United States vs. Ludey, supra,** at page 297.

3"The aggregate for depreciation and depletion claimed by Ludey in the income tax returns for the years 1913, 1914, 1915 and 1916, and allowed, was only $5,156. He insists that more cannot be deducted from the original cost in making the return for 1917. The contention is unsound. The amount of the gain on the sale is not dependent on the amount claimed in earlier years. If in any year he has failed to claim, or has been denied, the amount to which he was entitled, rectification of the error must be sought through a review of the action of the Bureau for that year. He cannot choose the year in which he will take a reduction." **United States vs. Ludey, supra,** at page 304.

4"On the other hand, we cannot accept the Government's contention that the full amount of depreciation and depletion sustained, whether allowable by law as a deduction from gross income in past years or not, must be deducted from cost in ascertaining gain or loss. Congress doubtless intended that the deduction to be made from the original cost should be the aggregate amount which the taxpayer was entitled to deduct in the several years." (Emphasis supplied.) **United States vs. Ludey, supra,** at page 304.

ing any theory of final and conclusive accounting in a single year (Br. 12-13), the opinion expressly denies it: "The amount of the gain on the sale is not dependent on the amount claimed in earlier years."[5] Second, the case involved the straight-line method of depletion and depreciation, which necessarily requires that deductions be taken on the basis of a more or less arbitrary estimate at a uniform rate each year, so that, once embarked upon the process, the taxpayer "cannot choose the year in which he will take a reduction." The invested capital is recovered ratably over a group of years, rather than on the basis of the events of a single year; and this is not true of other forms of capital recovery. Third, the depletion and depreciation had in fact occurred. Over the entire period oil had been extracted and sold, and equipment had been used and consumed, so that it was in fact depleted and depreciated property which was sold. The Court recognized economic fact. The error in theory was that of the taxpayer who had failed to claim the full deductions to which he was entitled by reason of this return of his capital investment.

> "The theory underlying this allowance for depreciation is that *by using up the plant, a gradual sale is made of it.* The depreciation charged is the measure of the cost of the part which has been sold." (Italics supplied.)
>
> *United States vs. Ludey,* at page 301.

That error, the Court found, might still be rectified by correction of earlier income tax returns. In the case at bar, the economic fact is that the taxpayers have had no gain, but a loss; and if there is error in theory, it is that of the Government in maintaining that the capital has been restored by a fiction.

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[5]United States vs. Ludey, supra, at page 304.

3. The Revenue Act of 1942, Section 116.

The Government contends (Br. 23-26) that the legislative history of Section 116 of the Revenue Act of 1942 indicates that Congress regarded reimbursement of items deducted without tax benefit in prior years as taxable income. It is of course clear that if such reimbursement was in fact a return of capital, which Congress has no power to tax, its belief in the matter cannot alter the situation. However, there is no clear indication that Congress entertained any such belief.

Prior to the enactment of the new Section, the Bureau had twice reversed its position with reference to reimbursement of bad debts previously deducted without tax benefit. Prior to 1937 it regarded such reimbursement as taxable income. In 1937, in G. C. M. 18525, 1937-1 C. B. 82, reaffirmed in G. C. M. 20854, 1939-1 C. B. 102, it concluded that it was not. In 1940, in G. C. M. 22163, 1940-a C. B. 76, it reverted to the opinion that such reimbursement was income, justifying its conclusion in part with the assertion that bad debts are operating expenses within the rule of *Burnet vs. Sanford & Brooks Co., supra.*[6] The same opinion drew the same conclusion as to prior deduction of taxes, and withdrew ac-

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[6] "Under the principle of the Supreme Court's decision in the Sanford & Brooks Co. case, supra, items of expense incurred in carrying on a trade or business do not represent capital investment, the cost of which, if converted, must first be restored before there is a capital gain taxable as income. Bad debts charged off in any business are deductible under a specific provision of the Revenue Acts rather than as ordinary and necessary business expenses. They are, nevertheless, under well-established accounting practices, recognized as operating expenses of the business deductible as such in arriving at the net operating gain or loss for the periods involved. See **Finney, Principles of Accounting,** 1934 Edition, Volume 1, page 37, and **Kester, Principles of Accounting,** Fourth Edition, pages 46, 116, and 554. Consequently the amount represented by debts which become worthless and are charged off in the carrying on of a trade or business is not to be considered as an investment of capital which must first be returned in full before taxable income is derived. Under this principle, amounts recovered in any taxable year upon debts previously charged off and allowed as a deduction should be treated as taxable income regardless of whether the prior allowance of the deduction resulted in a tax benefit to the taxpayer." G. C. M. 22163, 1940-2 C. B. 76, 79.

quiescence in decisions of the Board of Tax Appeals to the contrary. The Bureau took no express position with respect to the deduction of other types of losses. Meanwhile the Board of Tax Appeals, which had followed the first change of position, refused to follow the second one, and continued to hold that the reimbursement was not income unless there had been tax benefit (Br. 23).

In this state of affairs there was certainly "no such history of consistent and well settled Treasury regulations and interpretations adopted by Congressional acquiescence and re-enactment as will write into the Statute a rule to govern this case."

> *Philadelphia National Bank vs. Rothensies* (D. C. Pa., 1942), 43 F. Supp. 923, 925.

Rather the reasonable conclusion is that Congress disapproved the policy declared by the Bureau with respect to bad debts and taxes, and intended to overrule it and adopt the tax benefit position of the Board of Tax Appeals; and that the new Act refers only to bad debts, taxes and delinquency amounts for the reason that G. C. M. 22163 did not go beyond those items.

4. Administrative difficulties.

The Government's Brief makes much of administrative difficulties in the application of the "tax benefit" principle. It then proceeds to quote (Br. 24, note) from the Statement of Mr. Randolph Paul before the Ways and Means Committee of the House of Representatives, as follows:

> "It is believed that the hardships can be removed and the administrative difficulties kept to a minimum by excluding from income amounts received in payment of the debt to the extent that the deduction on account of the debt in the prior year did not produce a tax benefit. The troublesome question whether a benefit resulted

should be determinated pursuant to regulations prescribed by the Commissioner with the approval of the Secretary. It is also suggested that this treatment be extended to refunds of taxes previously deducted."

Administrative difficulties cannot transform loss in fact into gain in fact, or restitution of capital into income. But as to such minor difficulties as may arise, the Government has answered itself. There is no problem or difficulty suggested in the Brief (26-30) which will not in fact arise under the new provisions of the Revenue Act of 1942—including even the question whether a bad debt, a tax, or a delinquency amount shall be deemed to be the last deduction taken when all three were deducted in the same year. The representative of the Bureau has expressed to Congress entire confidence in the ability of the Bureau to meet these difficulties by appropriate regulations. It is not for the taxpayers to refuse to share that confidence. We have no more fear of an administrative breakdown as a result of a decision of this Court in our favor, than as a result of the enactment of the Revenue Act of 1942.

However that may be, the difficulties do not arise in the cases at bar. It is not disputed that the other deductions which reduced income to a net loss in 1930 and 1931 were properly taken, and that they were sufficient to leave no tax-free income available to restore the capital invested in stock of the National City Bank. Only one deduction for each year for each taxpayer is in question now. Unless that deduction resulted in an allocation of otherwise tax-free income to the restoration of capital, the capital investment has not been restored. The method of the Revenue Act of 1942 is to regard the deduction in question as the last one taken. That method is sufficient for this case. If, instead, it were to be regarded, for example, as the first taken, the only effect would be to allocate tax-free income to the restoration of this capital in-

vestment at the expense of some other legitimate deduction to which it might have been allocated instead. One uncompensated loss would be substituted for another, and the net loss on the year would remain the same. Such juggling of figures arrives nowhere. The reality is, as any business man would recognize, that the taxpayers were unable to restore their capital out of income in 1930 and 1931 because they had no income left.

Respectfully submitted,

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525636—43

In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 930

JOHN V. DOBSON, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

No. 931

E. W. DOBSON, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

No. 932

ESTATE OF JAMES N. COLLINS, DECEASED, FIRST NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, EXECUTOR PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

No. 933

H. J. HARWICK, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 62–67) in *John V. Dobson* v. *Commissioner* is reported in 46 B. T. A. 770, and its opinion (R. 15–20) in *Estate of James N. Collins* v. *Commissioner* is reported in 46 B. T. A. 765. The memorandum opinions of the Board in *E. W. Dobson* v. *Commissioner* (R. 40–43) and in *Harwick* v. *Commissioner* (Harwick R. 10–14) are not officially reported.

The opinion of the Circuit Court of Appeals (R. 3–14) [1] is reported in 133 F. (2d) 732.

JURISDICTION

The judgments of the Circuit Court of Appeals were entered on March 2, 1943 (R. 15–18). The petition for writs of certiorari was filed April 15, 1943. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether sums recovered in settlement of actions to rescind purchases of stock constitute taxable income to the extent that losses taken upon sales of the stock in prior tax years did not exceed the taxpayers' net losses for those years.

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[1] It should be noted that the transcript of proceedings in the Circuit Court of Appeals begins with page 1 rather than page 83 as it should if continuous with the rest of the record. The Harwick record is also paged separately and it will be referred to as the Harwick record, to prevent confusion.

2. Whether (in the Harwick case) such sums recovered upon assertion of a claim constitute taxable income where net income was reported in the earlier year after deduction of the losses, but because of the availability of credits against net income there would have been no tax liability even without the deduction.

3. Whether the sums recovered, if taxable, constitute ordinary income or gains from the "sale or exchange of a capital asset" within the meaning of Section 117 (a) (4) of the Internal Revenue Code.

STATUTE INVOLVED

Internal Revenue Code:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business caried on for gain or profit, or gains or profits and income derived from any source whatever. * * * (U. S. C. Title 26, Sec. 22).

SEC. 23. DEDUCTIONS FROM INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

* * * * *

(2) if incurred in any transaction entered into for profit, though not connected with trade or business;

* * * * *

(U. S. C., Title 26, Sec. 23.)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) *Capital Assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), * * *

* * * * *

(4) *Long-term capital gain.*—The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 18 months, if and to the extent such gain is taken into account in computing net income;

* * * * *

(U. S. C., Title 26, Sec. 117.)

STATEMENT

The stipulated facts (R. 21–25, 44–47, 74–79, and Harwick R. 20–24) in each of the cases were

adopted by the Board as its findings of fact (R. 15–17, 40–42, 63–65, and Harwick R. 10–14). They may be summarized as follows:

Several years before the taxable year 1939, the four taxpayers, all residents of Minnesota, had individually purchased stock of the National City Company of New York. Each had sold a portion or all of the stock at losses which were deducted on his income tax returns. (R. 16, 40, 63.)

E. W. Dobson, upon the sale of 200 shares in 1930, deducted a loss of $49,302.56 on his 1930 return. The return showed a net loss (after all deductions) of $30,197.56. (R. 40, 46.) John V. Dobson, upon his sale of 200 shares in that year, deducted $62,271 on his 1930 return. The return showed a net loss (after all deductions) of $30,043.47. (R. 63–65.) Collins[2] sold 100 shares in 1930 and 1931, respectively, taking a loss of $41,600.80 for 1930 and a loss of $28,163.78 for 1931. He had net losses (after all deductions) of $65,896.51 for 1930 and $40,204.90 for 1931. (R. 16, 23, 24.) Harwick sold 100 shares in 1931 and deducted a loss of $34,451.28 for that year. He reported a net income of $12,042.03, but his return indicated that, due to certain credits, he owed no tax. (Harwick R. 11–12.)

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[2] Collins died on April 21, 1941, before his case was heard by the Board of Tax Appeals; his executor was substituted as petitioner, but for convenience Collins will be referred to here as the taxpayer (R. 15).

At first, each of these taxpayers considered their purchases and sales of this stock as closed and completed transactions; but several years later they learned that the stock of the National City Company had not been registered in accordance with the requirements of the Minnesota Blue Sky laws. Accordingly, Harwick asserted a claim against the National City Company and the other taxpayers filed suits against that company, each contending (1) that the stock had been sold to them without having been registered as required by state law, and (2) that the sales had been fraudulent. In the complaints filed in the three suits, a request was made for a rescission of the sale contracts and there was an offer to turn over the proceeds of the stock sales, or an equal number of shares plus income thereon. (R. 16, 41, 64, and Harwick R. 11.)

The three suits and Harwick's claim were settled in 1939 (R. 16, 41, 64; Harwick R. 11). E. W. Dobson received $31,432.80 allocable to the stock sold in 1930 (R. 41–42); John V. Dobson received $32,294.96 allocable to his stock sold in 1930 (R. 64–65); Collins received $23,296.45 allocable to the stock sold in 1930 and $6,454.18 allocable to the stock sold in 1931 (R. 16–17). Harwick received $17,000 (Harwick, R. 11). In all four cases the original purchase prices of the stocks exceeded the sums received on the sales in 1930 plus the recoveries in 1939.

Neither E. W. Dobson, John V. Dobson, nor Collins reported any of these recoveries as income for 1939 (R. 41–42, 64–65, 16–17). Harwick reported $9,884.22, conceding that he had recovered a tax benefit in that amount from the deduction in 1931 (Harwick, R. 11). Throughout the year 1939 adjustment of the liabilities for 1930 and 1931 was barred by the statute of limitations (R. 17, 42, 65; Harwick, R. 11).

The Commissioner returned the entire amounts of the recoveries to income. The Board held that they were subject to tax to the extent that the prior deductions had offset gross income. Accordingly, since E. W. Dobson's and Collins' net losses had exceeded their deductions, the Board reversed the Commissioner in these cases (R. 18–20, 43). In the case of John V. Dobson, the Board held that the recovery was taxable to the extent that the 1939 recovery exceeded the net loss for 1930 (R. 65–67). In the case of Harwick, the Board held that since he reported net income after all deductions in 1931, the loss deduction in that year had resulted in a tax benefit, and therefore the entire amount recovered in 1939 should be included in his gross income (Harwick, R. 13–14). The Board further held in these latter two cases that the income was taxable as ordinary gain (R. 66; Harwick, R. 14).

The Circuit Court of Appeals sustained the Board in the Harwick case, and reversed in the

other three, holding that in each case the entire recovery was taxable as ordinary gain whether or not the prior deductions had resulted in a tax benefit (R. 15–18).

DISCUSSION

1. The decision below is in accord with the decisions of the Circuit Courts of Appeals for the Third and Fourth Circuits holding that recoveries of debts, previously charged off as worthless, constitute taxable income, whether or not the prior deductions resulted in a tax benefit. *Helvering* v. *State-Planters Bank & Trust Co.*, 130 F. 2d 44 (C. C. A. 4th); *Commissioner* v. *United States & Int. Sec. Corp.*, 130 F. 2d 894 (C. C. A. 3d).[3] These decisions are consistent with the principles enunciated in *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, 365, and *United States* v. *Ludey*, 274 U. S. 295. Recognition of the loss realized upon sale of the stock in the prior years assumes complete disposition of the capital asset for tax purposes. Consequently, any recovery in a future year is not a return of capital but is necessarily income within that year.

An analogous problem is now pending before this Court in *Virginian Hotel Corporation of Lynchburg* v. *Helvering*, No. 766. In that case, the

[3] The court has granted a rehearing in this case to determine the effect of Section 116 of the Revenue Act of 1942, Public Law 753, 77th Cong., 2d Sess. This statute does not touch the instant problem.

Fourth Circuit held that in computing the adjusted basis of property for depreciation purposes, excessive depreciation taken in prior years should be deducted from the taxpayers' cost basis as depreciation "allowed" within the meaning of Section 113 (b) (1) (B) of the Revenue Act of 1938, although it did not offset taxable income. The Government opposed certiorari in that case on the ground that although there was a conflict with *Pittsburgh Brewing Co.* v. *Commissioner,* 107 F. 2d 155 (C. C. A. 3d), that case was no longer authoritative in view of the Third Circuit's later decision in *Commissioner* v. *United States & Int. Sec. Corp., supra;* hence, we suggested that in the absence of a present conflict, this Court would be justified in denying the petition. As the Court granted certiorari in No. 766, apparently it was of the view that the two Third Circuit cases involved problems which were distinguishable. The problem in the instant case is essentially the same as that in the bad debt recovery cases, and therefore it would appear that the pendency of the *Virginian Hotel* case does not warrant certiorari here.

2. The second question, raised by the *Harwick case,* presents the problem of what constitutes a "tax benefit" if that is essential. There is no occasion for the Court's consideration of this point unless certiorari should be granted to review the basic issue.

3. The contention that the recoveries in settlement of the taxpayers' claims constituted "capital

gain" within the meaning of Section 117 (a) (4) of the Code is plainly without merit. Certainly, the recoveries did not constitute a "sale or exchange" of capital assets within the ordinary meaning of these terms. Cf. *Helvering* v. *Flaccus Leather Co.*, 313 U. S. 247. Consequently, even if the Court should grant the taxpayers' petition on the first two issues, we submit that review of the third issue is unnecessary.

CONCLUSION

The petition for certiorari should be denied.

Respectfully submitted.

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In the Supreme Court of the United States

OCTOBER TERM, 1943

No. 44

JOHN V. DOBSON, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

No. 45

E. W. DOBSON, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

No. 46

ESTATE OF JAMES N. COLLINS, DECEASED, FIRST NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, EXECUTOR, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

No. 47

H. J. HARWICK, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Board of Tax Appeals in *Estate of James N. Collins* v. *Commissioner* (R. 52–58) is reported in 46 B. T. A. 765, and its opinion in *John V. Dobson* v. *Commissioner* (R. 105–110) is reported in 46 B. T. A. 770. The memorandum opinions of the Board in *Harwick* v. *Commissioner* (R. 9–13) and in *E. W. Dobson* v. *Commissioner* (R. 79–83) are not officially reported.

The opinion of the Circuit Court of Appeals (R. 128–136) is reported in 133 F. 2d 732.

JURISDICTION

The judgments of the Circuit Court of Appeals were entered on March 2, 1943 (R. 136–139). The petition for writs of certiorari was filed April 15, 1943, and was granted on June 14, 1943. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

The taxpayers realized losses upon the sales of certain securities which were claimed as deductions in their income tax returns for the years of sale. In three of the cases the taxpayers had net losses in those years; in the fourth case (Harwick) the taxpayer had net income, but available credits against net income relieved the taxpayer of any liability. Some years later claims were asserted

by the taxpayers against the original owners. These claims were settled within the taxable year by cash payments.

The questions are:

(1) Do the recoveries constitute taxable income to the extent that the prior deductions did not result in a "tax benefit"?

(2) If the "tax benefit" rule were adopted, how should the tax benefit be determined?

(3) If the recoveries are taxable, do they constitute ordinary income, or gains from the "sale or exchange" of a capital asset within the meaning of Section 117 (a) (4) of the Internal Revenue Code?

STATUTES INVOLVED

The applicable statutes are set forth in the Appendix, *infra*, pp. 34–38.

STATEMENT

The stipulated facts (R. 18–23 (Harwick), 59–64 (Collins), 84–88 (E. W. Dobson), 118–123 (John Dobson)) in each of the cases were adopted by the Board of Tax Appeals as its findings of fact (R. 9–12 (Harwick), 53–55 (Collins), 79–83 (E. W. Dobson), 105–109 (John Dobson)). They may be summarized as follows:

Some years before the taxable year 1939, the four taxpayers, all residents of Minnesota, had individually purchased stock of the National City Company of New York. Each had sold a portion or all of the stock at losses which were deducted on his income tax returns. (R. 10, 53, 80, 105–106.)

E. W. Dobson, upon the sale of 200 shares in 1930, deducted a loss of $49,302.56 on his 1930 return. The return showed a net loss (after all deductions) of $30,197.56; however, Dobson was properly entitled to an additional loss of $2,350 upon the transaction (R. 80, 81). John V. Dobson, upon his sale of 200 shares in that year, deducted $62,271 on his 1930 return. The return showed a net loss (after all deductions) of $30,043.47 (R. 106, 107). Collins[1] sold 100 shares in 1930 and 1931, respectively, sustaining deductible losses of $41,600.80 for 1930 and $28,163.78 for 1931. He had net losses (after all deductions) of $65,896.51 for 1930 and $40,204.90 for 1931. (R. 53, 63.) Harwick sold 100 shares in 1931 and deducted a loss of $34,451.28 for that year. He reported a net income of $12,042.03, but his return indicated that, due to certain credits, he owed no tax. (R. 10–11.)

At first, the taxpayers considered their purchases and sales of this stock as closed and completed transactions; but several years later they learned that the stock of the National City Company had not been registered in accordance with the requirements of the Minnesota Blue Sky laws. Accordingly, Harwick asserted a claim against the National City Company and the other

[1] Collins died on April 21, 1941, before his case was heard by the Board of Tax Appeals; his executor was substituted as petitioner, but for convenience Collins will be referred to here as the taxpayer (R. 53).

taxpayers filed suits against that company, each contending (1) that the stock had been sold to him without having been registered as required by state law, and (2) that the sales had been fraudulent. In the complaints filed in the three suits, a request was made for a rescission of the sale contracts and there was an offer to turn over the proceeds of the stock sales, or an equal number of shares plus income thereon. (R. 10, 54, 80–81, 106–107.)

The three suits and Harwick's claim were settled in 1939. E. W. Dobson received a total net recovery of $31,432.80 allocable to the stock sold in 1930 (R. 81); John V. Dobson received $32,294.96 allocable to his stock sold in 1930 (R. 107); Collins received a net of $23,296.45 allocable to the stock sold in 1930 and $6,454.18 allocable to the stock sold in 1931 (R. 54). Harwick received $17,000 (R. 10). In all four cases costs of the stock exceeded the sums received on the sales in 1930 plus the recoveries in 1939.

Neither E. W. Dobson, John V. Dobson, nor Collins reported any of these recoveries as income for 1939 (R. 55, 82, 108). Harwick reported $9,884.22, conceding that he had recovered a tax benefit in that amount from the deduction in 1931 (R. 10). Throughout the year 1939 adjustment of the liabilities for 1930 and 1931 was barred by the statute of limitations (R. 54, 82, 108).

The Commissioner transferred the entire amounts of the recoveries to income. The Board

ruled that they were subject to tax only to the extent that they exceeded the amounts by which the prior allowable deductions had not offset taxable income. Accordingly, in the case of E. W. Dobson, the Board reversed the Commissioner since the recovery was less than the net losses in the prior year (R. 83). Similarly, in the case of Collins, the Board reversed since upon its theory no part of the prior deductions offset gross income (R. 58). In the case of John V. Dobson, the Board held that the recovery was taxable to the extent that the 1939 recovery exceeded the net loss for 1930 (R. 109–110). In the case of Harwick, the Board held that since he reported net income after all deductions in 1931, the loss deduction in that year had resulted in a tax benefit, and therefore the entire amount recovered in 1939 should be included in his gross income (R. 12–13). The Board further held in these latter two cases that the income was taxable as ordinary gain (R. 13, 110).

The Circuit Court of Appeals sustained the Board in the Harwick case, and reversed in the other three, holding that in each case the entire recovery was taxable as ordinary gain whether or not the prior deductions had resulted in a tax benefit (R. 130–136).

SUMMARY OF ARGUMENT

1. The principal question in this case turns on the application of the settled principle that the single

year is the unit of taxation. The taxpayers' claims, upon their disposition by settlement in 1939, had a basis of zero for determining gain or loss. This results from the adjustments required by the receipts and losses allowable upon the sales of the stock in prior closed years under the relevant provisions of the statute and the rule established by *United States* v. *Ludey,* 274 U. S. 295. The investment was closed out in those earlier tax years. Consequently, the entire proceeds of the settlement constituted "gain" and hence "income" within the year 1939. It is immaterial, as in the case of adjustments to basis for prior depreciation or depletion "allowable," that the years in which taxpayers were entitled to the deductions were net loss years. It is also immaterial, under *Burnet* v. *Sanford & Brooks Co.,* 282 U. S. 359, that the over-all transactions may have resulted in losses.

The statute allowed the taxpayers an opportunity to recoup their investment tax-free in the prior years. In the absence of specific statutory authority such as that provided by the loss carry-over provisions or by the new special provisions of Section 116 of the Revenue Act of 1942 relating to bad debts, prior taxes, or delinquency amounts, there is no reason why the circumstance of the subsequent recovery should entitle them to a second opportunity which would not otherwise be available. The legislative history of Section

116 itself shows plainly that Congress did not regard the tax benefit theory as part of the law.

A further argument against the tax benefit rule is presented by the problem of how the presence or absence of a "tax benefit" should be determined. There would clearly be no warrant for going as far as the taxpayers who urge that there must be a dollar tax advantage. If the deductions here in fact offset gross income, the original investment unquestionably had been recouped in the prior year, although available credits would in any event have relieved the taxpayers of any tax liability. Moreover, it cannot be assumed that these loss deductions were deducted from gross income only after all other deductions or credits had been taken. All deductions must have contributed proportionately in producing the net losses. But this would lead to conflict with the legislative intention that the deductions specifically covered by Section 116 should be deemed to have been the last deducted. The potential conflict is substantial additional evidence that Congress regarded the tax benefit rule as inapplicable in any situation except that expressly dealt with by it.

2. The proceeds of the settlement plainly constituted ordinary income, rather than gain from the "sale or exchange" of a capital asset. The compromise cannot appropriately be characterized as a sale or an exchange. The taxpayers' claims were extinguished; they were not transferred. Cf.

Helvering v. *Flaccus Leather Co.*, 313 U. S. 247; *Fairbanks* v. *United States*, 306 U. S. 436. The facts do not justify the attempt to regard the settlement as a receipt from the sale of the stock to third parties in the earlier years.

ARGUMENT

I

THE COURT BELOW CORRECTLY HELD THAT THE PROCEEDS OF THE SETTLEMENTS CONSTITUTED TAXABLE INCOME.

This Court, in *Griffiths* v. *Commissioner*, 308 U. S. 355, held that where securities were sold and a loss allowed, payments subsequently received in settlement of a fraud claim asserted against the original vendor were income in the later year. The principal question here is whether a different rule should apply where the taxpayer's returns for the earlier year, in which the securities were sold and the loss realized under the statute, showed a net loss. The court below held not, and we think the decision was clearly correct.

We start with the settled proposition that the single year is the unit of taxation. Income is computed on the basis of an annual accounting for gains and losses realized, i. e., on the basis of transactions closed within each taxable year. *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359; *Woolford Realty Co.* v. *Rose*, 286 U. S. 319, 326; *Virginian Hotel Corp.* v. *Helvering*, No. 766, 1942

Term.[2] These taxpayers, at the beginning of the tax year 1939, held claims against their vendors. Within that year they disposed of the claims by settlement. The problem is whether the funds thus realized from the settlement constituted "gain" and hence "income" measured by the transactions occurring *within the year 1939*. The answer necessarily turns on the basis of the claims for tax purposes. Cf. *Elverson Corp. v. Helvering*, 122 F. 2d 295, 297 (C. C. A. 2d); *Helvering v. Roth*, 115 F. 2d 239, 241 (C. C. A. 2d). Our view is that their basis was zero, and that consequently the entire recovery was income. This follows from the application of the relevant statutory provisions and from the principles established in *United States* v. *Ludey*, 274 U. S. 295.

1. Supplementing the broad definition of gross income contained in Section 22 (a) of the Code, Section 22 (f) (Appendix, *infra*) provides that upon "sale or other disposition of property, the gain or loss shall be computed as provided in section 111." Under Section 111 (a)

[2] Treasury Regulations 103, Section 19.43-2, issued under the Internal Revenue Code provide: "The expenses, liabilities, or deficit of one year cannot be used to reduce the income of a subsequent year." The same language appears in regulations issued under prior Revenue Acts including those in force in the years when the taxpayers sustained their losses on the sales of the stock. See, e. g., Treasury Regulations 74, Article 342, issued under the Revenue Act of 1928. The Circuit Court of Appeals regarded the taxpayers' position in the instant cases as inconsistent with this regulation. (R. 132.)

(Appendix, *infra*) the gain from the sale "or other disposition of property" is the excess of the amount realized over the adjusted basis provided in Section 113 (b). Section 113 (b) specifies the adjustments to be made to the basis determined under subsection (a), that is, to the cost basis, subject to exceptions which are not here material. Under paragraph (1) of subsection (b), proper adjustment must be made, *inter alia*, "(A) for expenditures, receipts, *losses*, or other items, properly chargeable to capital account" [italics supplied], and under clause (B) for depreciation and depletion "to the extent allowed (but not less than the amount allowable) under this chapter or prior income tax laws."

The theory of the statutory provisions is evident. It is fundamental that gain upon the disposition of a capital item is taxable to the extent that it exceeds the unrecovered investment. Therefore any capital expenditures must be added to the original cost in order to reflect the full investment made by the taxpayer. Conversely capital receipts representing prior tax-free returns of capital must first be deducted in order to prevent a second exclusion from gross income. Similarly, losses chargeable to capital account and depreciation or depletion charges reflect a prior disposition of the assets for which the statute allows a deduction. The right to a deduction for loss of capital is treated as the equivalent, for tax purposes, of a prior capital

return in computing the gain realized upon subsequent disposition of the remaining property interest.

In 1930 and 1931, the taxpayers upon the sale of their shares had had a portion of their original capital investments returned to them in the form of cash and had realized deductible losses covering the balance. These were closed transactions. The losses could be taken only in those years. The subsequent discovery of the claims against the original vendors showed that the taxpayers still retained a property interest arising from the original purchases of the shares. But we think it clear that in determining the basis of the claims both the language and the theory of Section 113 (b) (1) (A) requires an adjustment for the receipts and the losses realized upon the sales of the shares in the prior years.

The statute says nothing of prior "tax benefits". Prior capital receipts are properly deducted from the basis, although in the year of their receipt the taxpayer may have had sufficient deductions so that the exclusion of the receipts from gross income resulted in no actual tax advantage. There is no suggestion that comparable deductions allowable in the prior years are to be treated differently. To the extent of these exclusions or deductions the transaction has been closed in the prior years. There has been an accounting between the Government and the taxpayer in those years. The investment has been terminated for

tax purposes and the rights determined accordingly. A second opportunity to take the exclusions or the deductions to which the taxpayer was entitled is not afforded upon a later disposition of the property still retained.

The *Ludey* case, *supra,* is a judicial recognition of the validity of the theory underlying these provisions. The question there was the basis for determining gain realized upon the sale of depletable property. The Court held that the original cost basis should be reduced by the amount of depletion allowable in prior years, although the taxpayer had claimed less in his returns, and although the deductions allowable might be less than the depletion in fact sustained. The proceeds of the sale in excess of that depleted cost were classed as income...

The fundamental nature of the decision is emphasized by the fact that the result did not depend upon an express statutory provision for adjustment of basis upon sale of property such as that now contained in Section 113 (b) of the Code. The Court treated depreciation and depletion allowances as representing the loss of capital investment on the theory that "by using up the plant, a gradual sale is made of it" (p. 301). The cost thus previously deductible must be eliminated from basis in order to determine the cost of the remaining property sold within the taxable year. The fact that the deductions were not claimed is immaterial, since the taxpayer cannot choose the

year in which he will take a deduction. The Court considered the right to the deduction provided by the statute as intended to be regarded as a return of capital; in answering the contention that the deduction for depletion was allowed as a special bonus for enterprise and willingness to assume risks and should not be regarded as reducing the investment, the Court said (pp. 302–303):

> The Corporation Tax Law of 1909 had failed to provide for any deduction on account of the depletion of mineral reserves. *Stratton's Independence* v. *Howbert*, 231 U. S. 399; *von Baumbach* v. *Sargent Land Co.*, 242 U. S. 503; *United States* v. *Biwabik Mining Co.*, 247 U. S. 116; *Goldfield Consolidated Mines Co.* v. *Scott*, 247 U. S. 126. The resulting hardship to operators of mines induced Congress to make provision in the Revenue Law of 1913 and all later Acts for some deduction on account of depletion in determining the amount of the taxable income from mines. It is not lightly to be assumed that Congress intended the fact to be ignored in determining whether there was a loss or a gain on a sale of the mining properties. The proviso limiting the amount of the deduction for depletion to the amount of the capital invested shows that the deduction is to be regarded as a return of capital, not as a special bonus for enterprise and willingness to assume risks.

In the *Ludey* case, to be sure, it does not appear that the prior years, for which the depletion deductions were allowable, were net loss years. The

decision, however, implicitly rejects the theory that the taxpayer must have received a tax benefit from the allowances before they can be treated as a return of capital in the prior years; for it was held immaterial that the taxpayer had failed to claim the full amount allowable in its prior returns. The decisive fact was that the statute had recognized a prior disposition of a portion of the property in the prior years and had allowed the taxpayer an opportunity in those prior years for a *pro tanto* recovery of its investment tax-free. Thus subsequent decisions have consistently held that the basis for determining gain upon the sale of property must be reduced by prior depreciation or depletion "allowable" regardless of any question of prior tax benefit. *Hardwick Realty Co.* v. *Commissioner,* 29 F. 2d 498 (C. C. A. 2d); *Beckridge Corp.* v. *Commissioner,* 129 F. 2d 318 (C. C. A. 2d); see also *Kittredge* v. *Commissioner,* 88 F. 2d 632 (C. C. A. 2d); *Herder* v. *Helvering,* 106 F. 2d 153, 162 (App. D. C.), certiorari denied, 308 U. S. 617; *Jones* v. *Commissioner,* 72 F. 2d 114 (C. C. A. 8th). In the recent case of *Virginian Hotel Corp.* v. *Helvering, supra,* the opinion of the majority, which cited the *Beckridge* case, was predicated upon this assumption, and the dissenting opinion of the Chief Justice expressly negatived any intent to imply that "allowable" depreciation, whether deducted from the gross income or not may not properly be used to reduce basis. Noth-

ing in the dissenting opinion of Mr. Justice Jackson was to the contrary.

The taxpayers in the instant case are in a position wholly comparable with that of an owner of depreciable property which has been fully depreciated. Both own property upon which the original investment has been closed out for tax purposes. Under the statutes, both have been intitled to deductions equalling the otherwise unrecovered cost of their investment. Like fully depreciated property, the taxpayers' claims thus have a zero basis.[3]

2. The taxpayers argue that gain or loss upon the disposition of capital, in contrast with the recognition of ordinary income or the allowance of deductions for ordinary business expenditures, should not be determined by events occuring in a single tax year, but upon the transaction as a whole. (Br. 20–23.) Their entire case rests upon this proposition. We think it fundamentally wrong. The theory of the single tax year is basic in our income tax system, and there is no justification for drawing the distinction urged.

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[3] The taxpayers refer in their brief to the fact that in the *John V. Dobson* case, the Commissioner did not press before the Board of Tax Appeals the taxability of the portion of his recovery allowable to shares sold in 1931 upon which no loss had been claimed. (Br. 29, R. 110.) This was in accord with the administrative position which was taken with respect to bad debts in view of provisions found in the regulations since 1921. This ruling on bad debts was based on considerations of administrative fair play; it expressly noted that the *Ludey* decision indicated the contrary result. G. C. M. 22163, 1940–2 Cum. Bull. 76.

The *Ludey* case, of course, gave full recognition to the application of the principle to capital transactions, as have the cases, discussed above, which hold that basis must be reduced by prior "allowable" depreciation whether or not the prior years were loss years.[4] Although *Burnet* v. *Stanford & Brooks Co., supra,* did not involve capital transactions in the ordinary sense, the decision necessarily leads to the same conclusion.

In the *Sanford & Brooks Co.* case, the taxpayer had undertaken to perform a dredging contract with the United States during the tax years 1913 to 1916. It added to its gross income the payments made under the contract for those years and deducted the expenditures. The expenditures were greatly in excess of the receipts, and the returns for three of the four years showed net losses. Subsequently, suit was brought in the Court of Claims against the United States for breach of warranty, and in 1920 the taxpayer recovered the amount by which its expenditures had exceeded its receipts. The transaction as a whole had not shown a profit, and the returns in

[4] In *Beckridge Corp* v. *Commissioner*, *supra*, the court said (p. 319): "Without repeating the discussion in the *Hardwick* case, it will suffice to say that the petitioner's argument misconceives (1) the theory of depreciation as explained in *Ludey* case and (2) the theory of annual accounting which may produce a taxable profit in one year even though a loss sustained in another makes the whole transaction nonprofitable. See *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, 51 S. Ct. 150, 75 L. Ed. 383."

three of the four prior years for which the expenditures were deductible showed net losses. Nevertheless, the Court sustained the inclusion of the recovery in the taxpayer's gross income for that year.

Two propositions were settled by the decision: (1) Gain or loss is properly ascertained on the basis of a fixed annual accounting period, and income computed annually as the net result of all transactions within the year is properly taxable although there may have been a loss on the over-all transaction; (2) deductions attributable to such a transaction which are allowable in prior years cannot, in the absence of specific statutory authority, be carried over to offset the income realized in the later year although the prior years were net-loss years. We can perceive neither logical basis nor practical reason for a departure from the application of these principles to cases involving the disposition of capital items.

We think a different conclusion is not indicated by the Court's statement that, "They [the expenditures on the contract] were not capital investments, the cost of which, if converted, must first be restored from the proceeds before there is a capital gain taxable as income. See *Doyle* v. *Mitchell Brothrs Co.* [247 U. S. 179, 185]" (p. 364). The thought underlying this statement, as we understand it, was that if these were capital expenditures

they would properly have been added to basis at the time made rather than being deducted as a business expense. On this assumption, the taxpayer, at the time of recovery, would not have had any prior right to recoup the investment, and therefore it would have been necessary to allow a recoupment from the recovery before any gain was realized. The Court neither said nor implied, however, that if the statute has once given a taxpayer the right to deduct a capital expenditure, a second deduction must be allowed before gain is recognized if the first did not result in a tax advantage. We think the Court did not intend to give deductions for capital losses a special status different from the deductions for business expenditures and ordinary losses.[5]

The taxpayers here have suffered from the misfortune that sometimes results from the single year theory of income taxation. The deduction, attributable to this transaction, was allowable in a year when apparently other deductions or credits

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[5] The taxpayers rely on the decision in *Bowers* v. *Kerbaugh-Empire Co.*, 271 U. S. 170, where it was held that a reduction in an indebtedness did not constitute income where the borrowed funds had previously been expended on projects productive of losses in excess of the debt reduction. But to the extent the opinion contains language intimating that gain under the Sixteenth Amendment must be measured on a transactional basis, the case must be regarded as having been disapproved by the decision in *Burnet* v. *Sanford & Brooks Co.*, *supra*. See Magill, *Taxable Income*, 212, 215, 219–226.

were sufficient to consume most or all of the taxable income of that year. The proceeds were received in a later year of insufficient deductions or credits. From a practical standpoint, the taxpayers are in a position identical with that of the taxpayer in *Burnet* v. *Sanford & Brooks Co., supra.*[6] As we have emphasized, under the statute a taxpayer is given one opportunity to deduct an expense or to recoup a lost capital investment; that opportunity is in the year of realization. Specific statutory authority is required before another opportunity can be claimed.

Congress has dealt with the problem of "lost" deductions in the loss carry-over provisions of the

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[6] The principle of the single tax year does not mean that facts occurring in past years are not considered at all in determining the tax consequences of transactions closed in the current year. They have to be. In *Burnet* v. *Sanford & Brooks Co., supra*, the fact that the recovery constituted "gross income" depended upon a knowledge of the nature of the contract and work in prior years from which the recovery arose. In any case involving the disposition of property, it is necessary to know what the taxpayer started with at the beginning of the year in order to measure his gain within the year.

The import of the principle is that the taxpayer's gain or loss for each taxable year must be determined, and each taxable year closed, solely on the basis of the income realized and the deductions allowable within that year. Thus, in *Burnet* v. *Sanford & Brooks Co.*, the expenditures made incident to the contract in prior years could not be deducted from the income of the later taxable year. Similiarly in *United States* v. *Ludey, supra*, depletion allowable in earlier years had to be eliminated from basis in determining the unrecovered cost of the property sold in the later taxable year since it represented the equivalent of a return of capital in the prior year.

various revenue laws.[7] Within those carefully circumscribed situations, further opportunities are afforded to take deductions which had proved valueless in other years. If the taxpayers here were entitled to the benefit of such provisions, they would have been entitled to a further opportunity to deduct their losses realized in 1930 and 1931. Since this relief was not available under the statute, they now seize upon the circumstance that *in a future year* unexpected additional proceeds were recovered from the property to justify another opportunity to recoup the lost investment by an exclusion from gross income.

This, in true practical effect, is the "tax benefit" argument. We can perceive no reason why the

[7] The Revenue Act of 1928, Section 117 (b), authorized a limited two-year net loss carry-over. In the Revenue Act of 1932, Section 117 (b) and (d), the carry-over was limited to one year. See H. Rep. No. 708, 72d Cong., 1st Sess., p. 23 (1939–1 Cum. Bull. (Part 2) 457, 473). Loss carry-over was eliminated by the National Industrial Recovery Act, c. 90, 48 Stat. 195, and not restored to the Revenue Acts until enactment of the Revenue Act of 1939, amending the Internal Revenue Code. See H. Rep. No. 855, 76th Cong., 1st Sess., p. 9.

Section 211 (a) and (b) of the Revenue Act of 1939 c. 247, 53 Stat. 862, added provisions for net operating loss carry-over to the Internal Revenue Code (Sections 23 and 122). A two-year carry-over is provided subject to certain restrictions. See also Section 117 (e) of the Internal Revenue Code authorizing a capital loss carry-over against capital net gains for the succeeding five years.

Section 153 of the Revenue Act of 1942, c. 619, 56 Stat. 798, amended the Internal Revenue Code (Section 122 (b)) by adding a provision authorizing a two-year net operating loss carry-back.

circumstance of the subsequent recovery should provide the basis for a judicial exception to the general rule. There is no right to recoup tax-free last year's losses from this year's income. The merchant whose capital investment is impaired by losses one year has no right to recoup that lost capital free from income tax the following year or years. Under *Burnet* v. *Sanford & Brooks Co., supra,* as we have emphasized, a taxpayer is not entitled to offset last year's expenditures from this year's income merely because they are both attributable to the same transaction. It would be anomalous to allow the taxpayers the relief they seek when it is denied in these wholly comparable situations.

3. An essentially similar question has arisen in cases where taxpayers have recovered upon debts which had been charged off as worthless in a prior year and where the prior deduction had resulted in no "tax benefit." Funds received in satisfaction of a debt, of course, ordinarily constitute a capital reimbursement of an investment. The Circuit Courts of Appeals for the Third and Fourth Circuits, however, have both held that in view of the prior deductions the recovery constitutes taxable income regardless of tax benefit. *Commissioner* v. *United States & Int. Sec. Corp.,* 130 F. 2d 894 (C. C. A. 3d); *Helvering* v. *State-Planters Bank & Trust Co.,* 130 F. 2d 44 (C. C. A. 4th). The court below cited these cases in sup-

port of its position. Cf. also *National Bank of Commerce* v. *Commissioner,* 115 F. 2d 875 (C. C. A. 9th).[8]

Following these decisions, Congress, in the Revenue Act of 1942, provided by specific statutory enactment that upon the recovery of bad debts, prior taxes, or "delinquency amounts," that portion of the prior allowance which did not result in a tax reduction should be excluded from gross income. Revenue Act of 1942, Section 116. It is abundantly clear, however, that Congress regarded the rule it was overturning as inexpedient in these three situations rather than erroneous under the previous law. The recommendation for the statutory change first appeared in a Statement by Randolph Paul, Tax Advisor to the Secretary of the Treasury, before the Ways and Means Committee of the House of Representatives on March 3, 1942. This Statement expressly recognized that, in the absence of a specific statutory exception, the recovery would be taxable

[8] The tax benefit rule was first rejected by the Board of Tax Appeals (*Lake View Trust & Savings Bank* v. *Commissioner*, 27 B. T. A. 290) but later accepted in part on the strength of a ruling by the General Counsel of the Bureau approving it with respect to bad debt recoveries. G. C. M. 18525, 1937–1, Cum. Bull. 80; G. C. M. 20854, 1939–1 Cum. Bull, 102. *Central Loan & Investment Co.* v. *Commissioner*, 39 B. T. A 981. Although these rulings have since been revoked as inconsistent with fundamental law (G. C. M. 22163, 1940–2 Cum. Bull. 76), the Board has continued to apply the tax benefit rule. *Citizens State Bank* v. *Commissioner*, 46 B. T. A. 964.

as income. The recommendation was based upon a weighing of conflicting considerations: on the one hand, the hardship which the application of the rule in bad debt cases had caused in certain cases; on the other hand, the administrative difficulties, serving to impede tax collection, which are produced by any departure from the annual system of taxation. On balance, it was thought that as a legislative matter, the former should prevail.[9] In their reports endorsing the measure,

[9] Statement of Randolph Paul (Hearings before the Committee on Ways and Means, House of Representatives, 77th Cong., 2d Sess., Vol. 1, pp. 80, 88):

"(c) *Recoveries of bad debts and taxes.*—If a taxpayer who has taken a bad debt deduction later receives payment of such debt, such payment must be included in his income even though he obtained no tax benefit from the deduction in the prior year. While this result is theoretically proper under our annual system of taxation, it may produce severe hardships in certain cases through a distortion of the taxpayer's real income. At the same time, any departure from our annual system of taxation always produces administrative difficulties which serve to impede the collection of taxes.

"It is believed that the hardships can be removed and the administrative difficulties kept to a minimum by excluding from income amounts received in payment of the debt to the extent that the deduction on account of the debt in the prior year did not produce a tax benefit. The troublesome question whether a benefit resulted should be determinated pursuant to regulations prescribed by the Commissioner with the approval of the Secretary. It is also suggested that this treatment be extended to refunds of taxes previously deducted."

both the Senate Finance Committee and the House Ways and Means Committee stated expressly that the section provided (S. Rep. No. 1631, 77th Cong., 2d Sess., p. 79; H. Rep. No. 2333, 77th Cong., 2d Sess., p. 69)—

> for the exclusion from gross income of amounts *otherwise includible in gross income* which are attributable to the recovery during the taxable year of a bad debt, prior tax, or delinquency amount, to the extent that such debt, tax, or delinquency amount did not operate to reduce the income tax liability of the taxpayer for any prior taxable year. [Italics supplied.]

Two points are plain: (1) Congress regarded such recoveries as income, whether or not there was a prior tax benefit, in the absence of a specific legislative change. (2) Congress intended to change the rule only with respect to those specific situations covered by Section 116. The instant case, of course, does not come within these exceptions. The legislative history of the amendment plainly bears against the judicial adoption of the tax benefit theory.

As Mr. Paul's statement recommending adoption of Section 116 points out, any departure from our annual system of taxation always produces administrative difficulties which serve to impede the collection of taxes. The present liberal provisions for loss carry-over and carry-back, and the provisions of Section 116 have necessarily

added substantially to the administrative burdens.[10] It is for Congress to determine whether it would be sound tax policy further to increase that burden by enlarging the scope of Section 116 to cover other situations as well. It is not a question for judicial decision. See *Burnet* v. *Sanford & Brooks, supra,* p. 367.

4. If the tax benefit rule were judicially adopted, the question would then arise of how it should be determined. The problem and its implications are themselves a persuasive argument against the theory. See *Helvering* v. *State-Planters Bank & Trust Co., supra,* p. 48.

The view taken by the Board of Tax Appeals was that there is a tax benefit if, and to the extent that, the deduction offsets gross income. Whether or not there is such an offset is ascertained by assuming that the deduction in issue was the last deduction taken on the return. Thus, the Board treats the deduction as having been of no tax benefit to the extent that it does not exceed the net loss. Unless the recovery is greater than that amount it is held not taxable.

The taxpayers enlarge upon the theory. They contend that the test is whether the loss reduced the amount of tax dollars which they were required to pay in the earlier year. Harwick, it

[10] Some of the complexities of the problem can be seen from an examination of the regulations adopted under Section 116. See Regulations 103, Section 19.22 (b) (12)–1, as added by T. D. 5288, 1943–15 Int. Rev. Bull. 2.

will be recalled, had net income in the earlier year after deduction of the loss, but he also had available certain credits against net income which relieved him of any tax liability. The argument is that the deduction produced no benefit to the extent that it could have been eliminated from the return and the credits would still have sufficed to prevent any liability. (Taxpayers' Br. 30.) Thus, the proceeds of the subsequent recovery would be taxable only insofar as they were in excess of an amount which could have been added to income in 1930 without producing any tax liability.[11]

If the tax benefit rule were adopted, however, it is difficult to see the basis for requiring more than that the deduction offset gross income. The argument for the rule is based on the principle that cost must be recouped before taxable gain is realized upon disposition of an asset. Adoption of the rule, as we analyze the problem, would result from a conclusion that the statutory right to a prior deduction does not suffice to satisfy the requirement. It would be entirely wrong, however, then to go so far as to say that the prior

[11] The same issue is also raised in the *John V. Dobson* case. There, the taxpayer's recovery exceeded the net loss in the prior years by approximately $2,000, and the Board held the recovery taxable to this extent. But if Dobson's subsequent recovery were added back to the loss in the prior year, there would have been no tax liability since the resulting net income would be offset by available credits. (Br. 43.)

deduction must result in a dollar tax advantage. On this theory, for example, the actual proceeds received by the taxpayers from the sales of their shares in prior years would not constitute a recovery of capital, if their exclusion from gross income did not result in a dollar tax advantage because of deductions or credits otherwise available to the taxpayers. Carried to its logical limits, this theory would treat prior deductions as not having resulted in "tax benefits" *pro tanto,* where they in fact reduced taxable net income in a year when the tax rates were lower, or when the taxpayer's net income did not reach the higher surtax brackets applicable to him in the later year. We think the most that could be expected under the tax benefit rule would be an actual exclusion by means of the deduction from the income which Congress undertakes to tax.[12]

How, then, is it determined whether, and to what extent, there has been such an exclusion? The Revenue Act of 1928 follows the usual pattern of allowing various deductions from gross income of which the loss deduction is one. Section 23. In computing the tax upon the net income thus

[12] As the taxpayers point out, the special relief provisions of Section 116 of the Revenue Act of 1942, which we have discussed above, adopted the test of whether the prior deduction had resulted in a reduction of the taxpayer's tax. But such legislative action is not evidence that the same result properly would follow from the development of a tax benefit theory judicially.

determined, specified credits are then allowed for the purpose of the normal tax, but not for the surtax. Revenue Act of 1928, Section 25; see also the provisions of Section 31 providing for an earned income credit.

Whatever the similarity in practical effect between a deduction and a credit in a given case, the statute plainly distinguishes between the two. The deductions offset the gross income. The credits are subsequently taken into account in the computation of the tax. The statutory scheme treats the deductions as offsetting the gross income, not the credits. We can perceive no basis for treating the credits as having this effect.

The Board of Tax Appeals would not go this far. But confronted with the fact that the aggregate of all available deductions exceeded the gross income, it assumed, as we have said, that the loss deduction was the last to be deducted. As between the various deductions, however, the statute provides no basis for an inference that any one is taken before or after the other. In the circumstances, it seems apparent that each of the deductions must be taken to have shared proportionally with its fellows in producing the net loss. Cf. *Butler Bros.* v. *McColgan,* 315 U. S. 501, 508, 509. We think that if the tax benefit rule were adopted, calculation of the benefit and lack of benefit would have to proceed on that basis.[13]

[13] This point was noted, but not reached, in *Virginian Hotel Corp.* v. *Helvering*, *supra*; in view of the stipulation of

But this leads to another complication. In the enactment of Section 116 of the 1942 Act, Congress indicated that it wished the bad debt, tax and delinquency amount deductions to be deemed to be the last deductions or credits taken. They will be treated as having been of no tax benefit if the taxpayer could have refrained from deducting them without affecting his tax due for the year of deduction. S. Rep. No. 1631, 77th Cong., 2d Sess., p. 80. See Regulations 103, Section 19.22 (b) (12)–1, as added by T. D. 5288, 1943–15 Int. Rev. Bull. 2.[14] The clash inherent between this statement of legislative intention respecting these three types of deductions and the judicial adoption of the tax benefit rule with respect to situations not covered by the Congressional enactment, is evident. The potential conflict is an objection in itself to an attempt to adopt such a rule by judicial action. It is substantial additional evidence that Congress regarded the tax benefit rule as inapplicable in any situation except that expressly dealt with by it.

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the parties in that case. See footnote 8 of the Court's opinion.

The taxpayers do not advance their case by arguing that the burden is with the Government to show that it suffered loss or damage from the prior deduction. (Br. 27–28.) The question, as we view it, is one of basis. It can be argued at least with equal force that the burden is on the taxpayers to establish the basis for the claims, and that in this connection they must show that their investment was not recouped through the prior deductions.

[14] These amendments were also made applicable to prior years. T. D. 5288, Par. 2.

II

THE COURT BELOW CORRECTLY HELD THAT THE PROCEEDS WERE TAXABLE AS ORDINARY INCOME AND NOT AS GAINS FROM THE SALE OR EXCHANGE OF A CAPITAL ASSET WITHIN THE MEANING OF SECTION 117 (a) (4) OF THE INTERNAL REVENUE CODE

The taxpayers make the alternative argument that if, as the Government contends, the proceeds of the settlements constituted income, they are not taxable as ordinary income but as long-term capital gain from the "sale or exchange" of a capital asset held for more than 18 months within the meaning of Section 117 (a) (4) of the Internal Revenue Code (Appendix, *infra*). The taxpayers would thereby be entitled to the benefit of the limitations placed upon the taxation of such gains by Section 117.

The court below correctly sustained the Board in rejecting this contention. Unlike Section 111 (a) of the Code, to which we have previously referred, Section 117 (a) (4) refers only to the "sale or exchange" of a capital asset and not broadly to the sale "or other disposition of" property. Cf. *Stokes* v. *Commissioner*, 124 F. 2d 335, 337–338 (C. C. A. 3d). This Court has made it clear that the terms "sale" and "exchange," as used in Section 117, must be given their ordinary

meaning. *Helvering* v. *Flaccus Leather Co.*, 313 U. S. 247; *Fairbanks* v. *United States*, 306 U. S. 436. Neither term, as the court below aptly points out (R. 136), is appropriate to characterize a settlement of a claim. Cf. *Helvering* v. *Flaccus Leather Co., supra*, p. 249. The claim is not sold; it is extinguished. See *Hale* v. *Helvering*, 85 F. 2d 819 (App. D. C.).

There is no warrant, moreover, for relating these recoveries back to the sales of the stock in 1930 and 1931, as the taxpayers contend (Br. 34–36). To be sure, if the shares had not been sold in 1930 and 1931, any recovery from the assertion of a claim against the original vendors in 1939 would not have been income in that year unless it exceeded the cost basis. The sales in 1930 and 1931 resulted in the receipt of cash and the right to the loss deductions in those years which in turn meant that the claims would have a zero basis in 1939. In this sense, the prior sales may have been the *sine qua non* of the gain in 1939. Nevertheless the sales and the subsequent settlement were two entirely separate and distinct transactions. We think it would distort the facts and unduly stretch the normal connotation of the statutory language to conclude that the gain in 1939 was "from" the 1930 and 1931 sales.

CONCLUSION

The judgment of the Court below was correct and should be affirmed.

Respectfully submitted.

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OCTOBER 1943.

APPENDIX

Internal Revenue Code (1939):

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(f) *Determination of Gain or Loss.*—In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in section 111.

* * * * *

(U. S. C. 1940 ed., Title 26, Sec. 22.)

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

* * * * *

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *

* * * * *

(U. S. C. 1940 ed., Title 26, Sec. 23.)

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

* * * * *

(U. S. C. 1940 ed., Title 26, Sec. 111.)

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

* * * * *

U. S. C. 1940 ed., Title 26, Sec. 112.)

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; * * *

* * * * *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) *General Rule.*—Proper adjustment in respect of the property shall in all cases be made—

(A) For expenditures, receipts, losses, or other items, properly chargeable to capital account, including taxes and other carrying charges on unimproved and unproductive real property, but no such adjustment shall be made for taxes or other carrying charges for which deductions have been taken by the taxpayer in determining net income for the taxable year or prior taxable years;

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this chapter or prior income tax laws. * * *

* * * * *

(U. S. C. 1940 ed., Title 26, Sec. 113.)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) *Capital assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (*l*);

(2) *Short-term capital gain.*—The term "short-term capital gain" means gain from the sale or exchange of a capital asset held for not more than 18 months, if and to the extent such gain is taken into account in computing net income;

* * * * *

(4) *Long-term capital gain.*—The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 18 months, if and to the extent such gain is taken into account in computing net income;

* * * * *

(U. S. C. 1940 ed., Title 26, Sec. 117.)

Sections 22 (a), 23 (e) (2), and 112 (a), Revenue Act of 1928, c. 852, 45 Stat. 791, are identical with the corresponding sections of the Internal Revenue Code.

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 22. GROSS INCOME.

* * * * *

(e) *Determination of gain or loss.*—In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in sections 111, 112, and 113.

* * * * *

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS:

(a) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

(b) *Adjustment of basis.*—In computing the amount of gain or loss under subsection (a)—

(1) Proper adjustment shall be made for any expenditure, receipt, loss, or other item, properly chargeable to capital account, and

(2) The basis shall be diminished by the amount of the deductions for exhaustion, wear and tear, obsolescence, amortization, and depletion which have since the acquisition of the property been allowable in respect of such property under this Act or prior income tax laws; * * *

* * * * * *

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; * * *

* * * * * *

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1943

No. 44

JOHN V. DOBSON,

Petitioner,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

No. 47

H. J. HARWICK,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR REHEARING

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Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR REHEARING

To the Honorable Harlan Fiske Stone, Chief Justice of the United States, and the Associate Justices of the Supreme Court of the United States:

COME NOW The above named petitioners and present this their petition for a rehearing in these cases:

I.

The Court's opinion in these cases was filed on December 20, 1943. This petition is filed under Rule 33 within twenty-five days after judgment is entered. The Court is also requested to enlarge the time within which the mandates in

these cases shall be issued until such time as this petition for rehearing is disposed of.

II.

Grounds for Petition for Rehearing.

The Board of Tax Appeals in a memorandum opinion involving the tax liability of H. J. Harwick, petitioner in No. 47 herein, and in the case of John V. Dobson, 46 B. T. A. 770, petitioner in No. 44 herein, held that because in the opinion of the Board certain tax benefit had been realized by the taxpayers as a result of a loss sustained upon the sale of stock of the National City Company in 1930 and 1931, a portion (in the case of John V. Dobson) or all (in the case of H. J. Harwick) of the recoveries in 1939 constituted taxable income. This Court in its opinion specifically affirmed this conclusion of the Board of Tax Appeals.

However, in addition to the issue as to whether or not the recoveries in 1939 constituted income or a return of capital, the taxpayers also contended before the Board that any portion of the recoveries which constituted taxable income were taxable as capital gain under Section 117 of the Internal Revenue Code and not as ordinary income. This question is of importance to the taxpayers because if the income is taxable as ordinary income all of the income is taxable, whereas if the income is taxable as capital gain only, fifty per cent of the income is taxable and the maximum effective tax thereon is limited to thirty per cent. The Board of Tax Appeals found it necessary to pass on this issue in both the John V. Dobson case and the H. J. Harwick case because of its decision that part or all of the recoveries involved in those cases constituted taxable income. The Board rejected the contentions of the taxpayers and held that the portion of the recoveries taxable to John V. Dobson and Harwick constituted

ordinary income and not capital pain under Section 117. This conclusion is contained in the following brief statement found in the opinion of the Board in the case of *John V. Dobson,* 46 B. T. A. 770, 774:

> "Petitioner's contention that the income so realized should be taxed as capital gain is denied on authority of *Avery R. Schiller,* 43 B. T. A. 594."

This conclusion of the Board was the subject of an appeal by both John V. Dobson and Harwick to the Circuit Court of Appeals for the Eighth Circuit. That Court affirmed the decision of the Board in this respect. This issue was again raised in the petition for certiorari filed with this Court, the grant of certiorari was not restricted and the issue was discussed in the petitioners' brief filed herein, pages 34 to 36.

This Court in its opinion refers to this question as an "alternative argument. In making this statement this Court referred specifically to the case of James N. Collins and failed to note that in view of the decision of the Board in the John V. Dobson and Harwick cases this issue was not an "alternative" issue which became immaterial in view of this Court's refusal to reverse the application by the Board of tax benefit rule. At no place in the opinion of this Court is consideration given to the question as to whether the amount held to be taxable by the Board in the case of John V. Dobson or Harwick is to be taxable as ordinary income or capital gain under Section 117. The holding of the Court as expressed in the next to the last paragraph of its opinion herein indicates clearly that this issue was not considered:

> "We only hold that no statute or regulation having the force of one and no principle of law compels the Tax Court to find taxable income in a transaction where as a matter of fact it found no economic gain and no use of the transaction to gain tax benefit. The error of the court below consisted of treating as a rule of law that which we think is only a question of proper accounting."

The arguments of petitioners in support of their contention that the taxable income, if any, realized by John V. Dobson and Harwick constituted capital gain are set forth in the original brief filed with this Court, pages 34 to 36. It will be noted from the discussion therein that the taxpayers' contention that the portion of the recovery held taxable to John V. Dobson and H. J. Harwick constituted capital gain is based on the fact that the existence of any taxable income depended on the occurrence of a sale in 1930 or 1931. We, therefore, argued that the taxable income was "from" a sale within the meaning of Section 117. In rejecting this contention we believe that the Board not only clearly misconstrued Section 117, and therefore committed an error of law, but also fell into an inconsistency in its analysis of the facts. As pointed out in the Government's brief and noted in the opinion of this Court, the Government contended that "The principal question in this case turns on the application of the settled principle that the single year is the unit of taxation." The quoted statement relates to the discussion of the tax benefit problem. The Board held in passing on the tax benefit question that it would look at the entire series of transactions, *i. e.*, that occurred in 1929, 1930, 1931, and 1939, in determining whether or not taxable income resulted from the recoveries in 1939. It is submitted that a similar analysis of the identical facts requires the conclusion that in determining whether or not the recovery in 1939 resulted from a sale or exchange, the series of transactions must also be regarded as a single integrated transaction.

As noted above, the decision of the Board that the taxable portion of the recoveries in 1939 here involved did not constitute capital gain was based solely on the authority of *Avery R. Schiller*, 43 B. T. A. 594. That case involved a recovery of the purchase price of stock which had become

worthless in a prior year but had never been sold. The sole fact upon which petitioners herein base their characterization of the 1939 recoveries as capital gain, *i. e.*, the sales in 1930 and 1931, did not exist in the Schiller case.

In view of the decision of this Court as to the finality of decisions of the Tax Court, it is necessary to consider briefly the question as to whether the characterization of the income here involved as ordinary income or capital gain is a question of law which may be reviewed by this Court, or is a question of fact which may not be reviewed by this Court. Whether or not this income was capital gain depends on whether it was realized "from the sale or exchange" of a capital asset within the meaning of the quoted phrase as contained in Section 117 (a) (4) of the Internal Revenue Code. This same issue, although involving different facts, was submitted to this Court in a series of cases decided in 1941:

Helvering vs. Hammel (1941), 311 U. S. 504, 61 Sup. Ct. 368;

Electro-Chemical Engraving Co., Inc., vs. Commissioner (1941), 311 U. S. 513, 61 Sup. Ct. 372;

Helvering vs. Nebraska Bridge Supply & Lumber Company (1941), 312 U. S. 666, 61 Sup. Ct. 827.

All of these cases involved the question as to whether the loss sustained on certain specified transactions, *i. e.*, the loss sustained by a debtor on a mortgage foreclosure sale and the loss sustained by an owner of land upon foreclosure of a tax lien, resulted from a "sale or exchange" so as to be properly characterized as a capital loss. The statutory provisions involved were identical to the portion of Section 117 of the Internal Revenue Code here involved. This Court in all three of the decided cases reversed the decision of the Board of Tax Appeals and held that the transactions involved constituted "sales or exchanges" and therefore resulted in capital losses. This Court indicated in the *Hammel* case, 311

U. S. 504, 510, that it regarded the problem involved as one of statutory construction and interpretation, *i. e.*, a question of law. We, therefore, submit that whether or not the income which the Board held to be taxable to John V. Dobson and H. J. Harwick is taxable as ordinary income or capital gain is a question of law which is properly before this Court for review, and that the principles enunciated by this Court in its opinion of December 20, 1943, herein do not restrict the scope of this review.

Respectfully submitted,

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I, Leland W. Scott, counsel for the above named petitioners, do hereby certify that the foregoing petition for a rehearing of this cause is presented in good faith and not for delay.

LELAND W. SCOTT.

p. 13.

SUPREME COURT OF THE UNITED STATES.

Nos. 44, 45, 46, 47.—October Term, 1943.

John V. Dobson, Petitioner,
44 *vs.*
Commissioner of Internal Revenue.

E. W. Dobson, Petitioner,
45 *vs.*
Commissioner of Internal Revenue.

Estate of James N. Collins, Deceased, First National Bank and Trust Company of Minneapolis, Executor, Petitioner,
46 *vs.*
Commissioner of Internal Revenue.

H. J. Harwick, Petitioner,
47 *vs.*
Commissioner of Internal Revenue.

On Writs of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

[December 20, 1943.]

Mr. Justice Jackson delivered the opinion of the Court.

These four cases were consolidated in the Court of Appeals. The facts of one will define the issue present in all.

The taxpayer, Collins, in 1929 purchased 300 shares of stock of the National City Bank of New York which carried certain beneficial interests in stock of the National City Company. The latter company was the seller and the transaction occurred in Minnesota. In 1930 Collins sold 100 shares, sustaining a deductible loss of $41,600.80, which was claimed on his return for that year and allowed. In 1931 he sold another 100 shares, sustaining a deductible loss of $28,163.78, which was claimed in his return and allowed. The remaining 100 shares he retained. He regarded the purchases and sales as closed and completed transactions.

In 1936 Collins learned that the stock had not been registered in compliance with the Minnesota Blue Sky Laws and learned of facts indicating that he had been induced to purchase by fraudulent representations. He filed suit against the seller alleging fraud and failure to register. He asked rescission of the entire transaction and offered to return the proceeds of the stock, or an equivalent number of shares plus such interest and dividends as he had received. In 1939 the suit was settled, on a basis which gave him a net recovery of $45,150.63, of which $23,296.45 was allocable to the stock sold in 1930 and $6,454.18 allocable to that sold in 1931. In his return for 1939 he did not report as income any part of the recovery. Throughout that year adjustment of his 1930 and 1931 tax liability was barred by the statute of limitations.

The Commissioner adjusted Collins' 1939 gross income by adding as ordinary gain the recovery attributable to the shares sold, but not that portion of it attributable to the shares unsold. The recovery upon the shares sold was not, however, sufficient to make good the taxpayer's original investment in them. And if the amounts recovered had been added to the proceeds received in 1930 and 1931 they would not have altered Collins' income tax liability for those years, for even if the entire deductions claimed on account of these losses had been disallowed, the returns would still have shown net losses.

Collins sought a redetermination by the Board of Tax Appeals, now the Tax Court. He contended that the recovery of 1939 was in the nature of a return of capital from which he realized no gain and no income either actually or constructively, and that he had received no tax benefit from the loss deductions. In the alternative he argued that if the recovery could be called income at all it was taxable as capital gain. The Commissioner insisted that the entire recovery was taxable as ordinary gain and that it was immaterial whether the taxpayer had obtained any tax benefits from the loss deduction reported in prior years. The Tax Court sustained the taxpayer's contention that he had realized no taxable gain from the recovery.[1]

The Court of Appeals concluded that the "tax benefit theory" applied by the Tax Court "seems to be an injection into the law of an equitable principle found neither in the statutes nor in the

[1] Estate of James N. Collins v. Commissioner, 46 B. T. A. 765.

regulations." Because the Tax Court's reasoning was not embodied in any statutory precept, the court held that the Tax Court was not authorized to resort to it in determining whether the recovery should b etreated as income or return of capital. It held as matter of law that the recoveries were neither return of capital nor capital gain, but were ordinary income in the year received.[2] Questions important to tax administration were involved, conflict was said to exist, and we granted certiorari.[3]

It is contended that the applicable statutes and regulations properly interpreted forbid the method of calculation followed by the Tax Court. If this were true, the Tax Court's decision would not be "in accordance with law" and the Court would be empowered to modify or reverse it.[4] Whether it is true is a clear-cut question of law and is for decision by the courts.

The court below thought that the Tax Court's decision "evaded or ignored" the statute of limitation, the provision of the Regulations that "expenses, liabilities, or deficit of one year cannot be used to reduce the income of a subsequent year,"[5] and the principle that recognition of a capital loss presupposes some event of "realization" which closes the transaction for good. We do not agree. The Tax Court has not attempted to revise liability for earlier years closed by the statute of limitation, nor used any expense, liability, or deficit of a prior year to reduce the income of a subsequent year. It went to prior years only to determine the nature of the recovery, whether return of capital or income. Nor has the Tax Court reopened any closed transaction; it was compelled to determine the very question whether such a recognition of loss had in fact taken place in the prior year as would necessitate calling the recovery in the taxable year income rather than return of capital.

The 1928 Act provides that "the Board in redetermining a deficiency in respect of any taxable year shall consider such facts with relation to the taxes for other taxable years as may be necessary correctly to redetermine the amount of such deficiency. . . ."[6] The Tax Court's inquiry as to past years was authorized if "neces-

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[2] 133 F. 2d 732.

[3] — U. S. —.

[4] Revenue Act of 1926 § 1003(b), 44 Stat. 9, 110, now Internal Revenue Code § 1141(c)(1).

[5] Treasury Regulations 103, § 19.43-2.

[6] Revenue Act of 1928 § 272(g), 45 Stat. 854, now Internal Revenue Code § 272(g).

sary correctly to redetermine" the deficiency. The Tax Court thought in this case that it was necessary; the Court of Appeals apparently thought it was not. This precipitates a question not raised by either counsel as to whether the court is empowered to revise the Tax Court's decision as "not in accordance with law" because of such a difference of opinion.

With the 1926 Revenue Act, Congress promulgated, and at all times since has maintained, a limitation on the power of courts to review Board of Tax Appeals (now the Tax Court) determinations. ". . . such courts shall have power to affirm or, if the decision of the Board is not in accordance with law, to modify or to reverse the decision of the Board . . ."[7] However, even a casual survey of decisions in tax cases, now over 5,000 in number, will demonstrate that courts including this Court have not paid the scrupulous deference to the tax laws' admonitions of finality which they have to similar provisions in statutes relating to other tribunals.[8] After thirty years of income tax history the volume of tax litigation necessary merely for statutory interpretation would seem due to subside. That it shows no sign of diminution suggests that many decisions have no value as precedents because they determine only fact questions peculiar to particular cases. Of course frequent amendment of the statute causes continuing uncertainty and litigation, but all too often amendments are themselves made necessary by court decisions. Increase of potential tax litigation due to more taxpayers and higher rates lends new importance to observance of statutory limitations on review of tax decisions. No other branch of the law touches human activities at so many points. It can never be made simple, but we can try to avoid making it needlessly complex.

It is more difficult to maintain sharp separation of court and administrative functions in tax than in other fields. One reason is that tax cases reach circuit courts of appeals from different sources and do not always call for observance of any administrative sphere of decision. Questions which the Tax Court considers at

[7] Revenue Act of 1926 § 1003(b), 44 Stat. 9, 110, now Internal Revenue Code § 1141(c)(1).

[8] Compare Helvering *v.* Tex-Penn Oil Co., 300 U. S. 481, and Bogardus *v.* Commissioner, 302 U. S. 34, with Rochester Telephone Corp. *v.* United States, 307 U. S. 125 (Federal Communications Commission); Shields *v.* Utah Idaho Central Railroad Co., 305 U. S. 177 (Interstate Commerce Commission); Sunshine Coal Co. *v.* Adkins, 310 U. S. 381, 399-400; Gray *v.* Powell, 314 U. S. 402 (Bituminous Coal Commission); National Labor Relations Board *v.* Waterman S. S. Co., 309 U. S. 206 (National Labor Relations Board).

the instance of one taxpayer may be considered by many district courts at the instance of others.

The Tucker Act authorizes district courts, sitting without jury as courts of claims, to hear suits for recovery of taxes alleged to have been "erroneously or illegally assessed or collected."[9] District courts also entertain common law actions against collectors to recover taxes erroneously demanded and paid under protest. Trial may be by jury, but waiver of jury is authorized[10] and in tax cases jury frequently is waived. In such cases the findings of the court may be either special or general. The scope of review on appeal may be affected by the nature of the proceeding, the kind of findings, and whether the jury was waived under a particular statutory authorization or independently of it.[11] The multiplicity and complexity of rules is such that often it is easier to review the whole case on the merits than to decide what part of it is reviewable and under what rule. The reports contain many cases in which the question is passed over without mention.

Another reason why courts have deferred less to the Tax Court than to other administrative tribunals is the manner in which Tax Court finality was introduced into the law.

The courts have rather strictly observed limitations on their reviewing powers where the limitation came into existence simultaneously with their duty to review administrative action in new fields of regulation. But this was not the history of the tax law. Our modern income tax experience began with the Revenue Act of 1913. The World War soon brought high rates. The law was an innovation, its constitutional aspects were still being debated, interpretation was just beginning, and administrators were inexperienced. The Act provided no administrative review of the Commissioner's determinations. It did not alter the procedure followed under the Civil War income tax by which an aggrieved taxpayer could pay under protest and then sue the Collector to test the correctness of the tax.[12] The courts by force of this situa-

[9] 28 U. S. C., § 41(20).

[10] 28 U. S. C. § 773; Act of May 29, 1930, c. 357, 46 Stat. 486.

[11] 28 U. S. C. § 875. See Carloss, Monograph on Findings of Fact (Supt. of Documents, 1934) 4. Some 280 cases on the review of findings of fact are considered.

[12] See Cheatham *v.* United States, 92 U. S. 85, 89.

tion entertained all manner of tax questions, and precedents rapidly established a pattern of judicial thought and action whereby the assessments of income tax were reviewed without much restraint or limitation. Only after that practice became established did administrative review make its appearance in tax matters.

Administrative machinery to give consideration to the taxpayer's contentions existed in the Bureau of Internal Revenue from about 1918 but it was subordinate to the Commissioner.[13] In 1923, the situation was brought to the attention of Congress by the Secretary of the Treasury, who proposed creation of a Board of Tax Appeals, within the Treasury Department, whose decision was to conclude Government and taxpayer on the question of assessment and leave the taxpayer to pay the tax and then test its validity by suit against the collector.[14] Congress responded by creating the Board of Tax Appeals as "an independent agency in the executive branch of the Government."[15] The Board was to give hearings and notice thereof and "make a report in writing of its findings of fact and decision in each case."[16] But Congress dealt cautiously with finality for the Board's conclusions, going only so far as to provide that in later proceedings the findings should be "prima facie evidence of the facts therein stated."[17] So the Board's decisions first came before the courts under a statute which left them free to go into both fact and law questions. Two years later Congress reviewed and commended the work of the new Board,[18] increased salaries and lengthened the tenure of its members,[19] provided for a direct appeal from the Board's decisions to the circuit courts of appeals or the Court of Appeals of the District of Columbia,[20] and enacted the present provision limiting review to questions of law.[21]

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[13] For an account thereof, see opinion of Mr. Justice Brandeis in Williamsport Wire Rope Co. *v.* United States, 277 U. S. 551, 562, n. 7.

[14] Annual Report of Secretary of Treasury, Finance 1 (1923) 10; Hamel, Practice and Evidence before the U. S. Board of Tax Appeals (1938) 5.

[15] Revenue Act of 1924 § 900(k), 43 Stat. 253, 336.

[16] *Id.*, § 900(h).

[17] *Id.*, § 900(g).

[18] H. R. Rep. No. 1, 69th Cong., 1st Sess.; Sen. Rep. No. 52, 69th Cong., 1st Sess.

[19] Revenue Act of 1926 §§ 901(a), 900, 44 Stat. 9, 106, 105.

[20] *Id.*, § 1001(a), 44 Stat. 9, 109.

[21] *Id.*, § 1003(b), 44 Stat. 9, 110.

But this restriction upon judicial review of the Board's decisions came only after thirteen years of income tax experience had established a contrary habit. Precedents had accumulated in which courts had laid down many rules of taxation not based on statute but upon their ideas of right accounting or tax practice. It was difficult to shift to a new basis. This Court applied the limitation, but with less emphasis and less forceful resolution of borderline cases in favor of administrative finality than it has employed in reference to other administrative determinations.[22]

That neglect of the congressional instruction is a fortuitous consequence of this evolution of the Tax Court rather than a deliberate or purposeful judicial policy is the more evident when we consider that every reason ever advanced in support of administrative finality applies to the Tax Court.

The court is independent, and its neutrality is not clouded by prosecuting duties. Its procedures assure fair hearings. Its deliberations are evidenced by careful opinions. All guides to judgment available to judges are habitually consulted and respected. It has established a tradition of freedom from bias and pressures.[23] It deals with a subject that is highly specialized and so complex as to be the despair of judges. It is relatively better staffed for its task than is the judiciary.[24] Its members not infrequently bring to their task long legislative or administrative experience in their subject. The volume of tax matters flowing through the Tax Court keeps its members abreast of changing statutes, regulations, and Bureau practices, informed as to the background of controversies and aware of the impact of their decisions on both Treasury and taxpaayer. Individual cases are

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[22] E. g., Helvering *v.* Rankin, 295 U. S. 123, 131; Helvering *v.* Tex-Penn Oil Co., 300 U. S. 481, 491; Bogardus *v.* Commissioner, 302 U. S. 34, 38-39. For a sample of the diverse treatment of Board decisions when reviewed by this Court, see Elmhurst Cemetery Co. *v.* Commissioner, 300 U. S. 37; Palmer *v.* Commissioner, 302 U. S. 63, 70; Helvering *v.* National Grocery Co., 304 U. S. 282, 294; Colorado National Bank *v.* Commissioner, 305 U. S. 23; Helvering *v.* Lazarus & Co., 308 U. S. 252; Griffiths *v.* Commissioner, 308 U. S. 355; Helvering *v.* Kehoe, 309 U. S. 277; Higgins *v.* Commissioner, 312 U. S. 212; Powers *v.* Commissioner, 312 U. S. 259; Wilmington Trust Co. *v.* Helvering, 316 U. S. 164, 168; Merchants National Bank of Boston *v.* Commissioner, No. 30, October Term, 1943. Compare the foregoing with the cases cited *supra* note 8.

[23] See reports of congressional committees on the Revenue Act of 1926, cited *supra* note 18.

[24] See Miller, Supporting Personnel of Federal Courts, 29 A. B. A. Journal 130, 131.

disposed of wholly on records publicly made, in adversary proceedings, and the court has no responsibility for previous handling. Tested by every theoretical and practical reason for administrative finality, no administrative decisions are entitled to higher credit in the courts. Consideration of uniform and expeditious tax administrations require that they be given all credit to which they are entitled under the law.

Tax Court decisions are characterized by substantial uniformity. Appeals fan out into courts of appeal of ten circuits and the District of Columbia. This diversification of appellate authority inevitably produces conflict of decision, even if review is limited to questions of law. But conflicts are multiplied by treating as questions of law what really are disputes over proper accounting. The mere number of such questions and the mass of decisions they call forth become a menace to the certainty and good administration of the law.[25]

To achieve uniformity by resolving such conflicts in the Supreme Court is at best slow, expensive, and unsatisfactory. Students of federal taxation agree that the tax system suffers from delay in getting the final word in judicial review, from retroactivity of the decision when it is obtained, and from the lack of a roundly tax-informed viewpoint of judges.[26]

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[25] "Judge-made law is particularly prolific in connection with federal taxation, coming, as it does, from so many courts of coordinate jurisdiction. And the constant outpouring of decisions has steadily increased in volume. For the year 1920 a leading tax service catalogued only 300 decisions; (CCH Federal Tax Service (1921)). . . . Today one must look to approximately 20,000 court and Board decisions, many pages of regulations, and about 5,000 rulings. Since 1924 the Board of Tax Appeals alone has published about 8,500 opinions, as well as approximately 4,000 unreported memorandum opinions. For the fiscal years 1935, 1936 and 1937, the number of Board dockets appealed to the Circuit Courts of Appeal has amounted, on the average, to 509 each year. The Supreme Court's balance sheet shows that federal taxation was the principal concern of that Court during the 1934 term, with 44 decisions being handed down in that field. During the three years, 1935, 1936, and 1937, the Supreme Court rendered decisions in 84 federal tax cases." Paul, Selected Studies in Federal Taxation (1938) 2, n. 2.

"As of December 31, 1936, 4,700 decisions had been appealed to the Circuit Courts of Appeal (or the Court of Appeals of the District of Columbia) of which 3,996 had been disposed of. This left a pending Appellate docket of 704." *Id.*, 140, n. 133.

[26] Paul, Selected Studies in Federal Taxation (1938) 204, n. 18, comments on the number and variety of the sources contributing to tax law.

See Griswold, Book Review, 56 Harv. L. Rev. 1354.

Magill, The Impact of Federal Taxes (1943) 209, says: "At the present time, it is impossible to obtain a really authoritative decision of general application upon important questions of law for many years after the close of any taxable year. The average period between the taxable year in dispute

Perhaps the chief difficulty in consistent and uniform compliance with the congressional limitation upon court review lies in the want of a certain standard for distinguishing "questions of law" from "questions of fact." This is the test Congress has directed, but its difficulties in practice are well known and have been subject of frequent comment. Its difficulty is reflected in our labeling some questions as "mixed questions of law and fact"[27] and in a great number of opinions distinguishing "ultimate facts" from evidentiary facts.[28]

It is difficult to lay down rules as to what should or should not be reviewed in tax cases except in terms so general that their effectiveness in a particular case will depend largely upon the attitude with which the case is approached. However, all that we have said of the finality of administrative determination in other fields is applicable to determinations of the Tax Court. Its decision, of course, must have "warrant in the record" and a reasonable basis in the law. But "the judicial function is exhausted when there is found to be a rational basis for the conclusions approved by the administrative body." *Rochester Telephone Corp.* v. *United States,* 307 U. S. 125, 146; *Swayne and Hoyt* v. *United States,* 300 U. S. 297, 304; *Mississippi Valley Barge Line* v. *United States,* 292 U. S. 282, 286-7; *Gray* v. *Powell,* 314 U. S. 402, 412; *Helvering* v. *Clifford,* 309 U. S. 331, 336; *United States* v. *L. & N. R. R. Co.,* 235 U. S. 314, 320; *Wilmington Trust Co.* v. *Helvering,* 316 U. S. 164, 168.

Congress has invested the Tax Court with primary authority for redetermining deficiencies, which constitutes the greater part of

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and a Supreme Court decision relating thereto is nine years. Meanwhile confusion reigns in the day-by-day settlement of the more debatable questions of the tax law. One circuit court holds that a certain situation gives rise to tax liability; another circuit holds the contrary. The Commissioner and the lower federal courts are both confronted with the problem of reconciling the irreconcilable. A great part of the criticism of changing interpretations of the law announced by the Commissioner of Internal Revenue is properly attributable to the multitude of tribunals with original jurisdiction in tax cases, and to the absence of provision for decisions with nationwide authority in the majority of cases. If we were seeking to secure a state of complete uncertainty in tax jurisprudence, we could hardly do better than to provide for 87 Courts with original jurisdiction, 11 appellate bodies of coordinate rank, and only a discretionary review of relatively few cases by the Supreme Court."

[27] E. g., Helvering *v.* Rankin, 295 U. S. 123, 131; Helvering *v.* Tex-Penn Oil Co., 300 U. S. 481, 491; Bogardus *v.* Commissioner, 302 U. S. 34, 39.

[28] E. g., Anderson *v.* Commissioner, 78 F. 2d 636; Childers *v.* Commissioner, 80 F. 2d 27; Eaton *v.* Commissioner, 81 F. 2d 332; Rankin *v.* Commissioner, 84 F. 2d 551.

tax litigation. This requires it to consider both law and facts. Whatever latitude exists in resolving questions such as those of proper accounting, treating a series of transactions as one for tax purposes, or treating apparently separate ones as single in their tax consequences, exists in the Tax Court and not in the regular courts; when the court cannot separate the elements of a decision so as to identify a clear-cut mistake of law, the decision of the Tax Court must stand. In view of the division of functions between the Tax Court and reviewing courts it is of course the duty of the Tax Court to distinguish with clarity between what it finds as fact and what conclusion it reaches on the law. In deciding law questions courts may properly attach weight to the decision of points of law by an administrative body having special competence to deal with the subject matter. The Tax Court is informed by experience and kept current with tax evolution and needs by the volume and variety of its work. While its decisions may not be binding precedents for courts dealing with similar problems, uniform administration would be promoted by conforming to them where possible.

The Government says that "the principal question in this case turns on the application of the settled principle that the single year is the unit of taxation." But the Tax Court was aware of this principle and in no way denied it. Whether an apparently integrated transaction shall be broken up into several separate steps and whether what apparently are several steps shall be synthesized into one whole transaction is frequently a necessary determination in deciding tax consequences.[29] Where no statute or regulation controls, the Tax Court's selection of the course to follow is no more reviewable than any other question of fact. Of course we are not here considering the scope of review where constitutional questions are involved. The Tax Court analyzed the basis of the litigation which produced the recovery in this case and the obvious fact that "regarding the series of transactions as a whole it is apparent that no gain was actually realized." It found that the taxpayer had realized no tax benefits from reporting the transaction in separate years. It said the question under these circumstances was whether the amount the taxpayer recovered in 1939 "constitutes taxable income, even though he realized

[29] See Paul, "Step Transactions", Selected Studies in Federal Taxation (1938) 203.

no economic gain." It concluded that the item should be treated as a return of capital rather than as taxable income. There is no statute law to the contrary, and the administrative rulings in effect at the time tended to support the conclusion.[30] It is true that the Board in a well considered opinion reviewed a number of court holdings, but it did so for the purpose of showing that they did not fetter its freedom to reach the decision it thought sound. With this we agree.

Viewing the problem from a different aspect, the Government urges in this Court that although the recovery is capital return, it is taxable in its entirety because taxpayer's basis for the property in question is zero. The argument relies upon § 113(b)(1)(A) of the Internal Revenue Code, which provides for adjusting the basis of property for "expenditures, receipts, losses, or other items properly chargeable to capital account." This provision, it is said, requires that the right to a deduction for a capital loss be treated as a return of capital. Consequently, by deducting in 1930 and 1931 the entire difference between the cost of his stock and the proceeds of the sales, taxpayer reduced his basis to zero. But the statute contains no such fixed rule as the Government would have us read into it. It does not specify the circumstances or manner in which adjustments of the basis are to be made, but merely provides that "Proper adjustment . . . shall in all cases be made" for the items named if "properly chargeable to capital account." What, in the circumstances of this case, was a proper adjustment of the basis was thus purely an accounting problem and therefore a question of fact for the Tax Court to determine. Evidently the Tax Court thought that the previous deductions were not altogether "properly chargeable to capital account" and that to treat them as an entire recoupment of the value of taxpayer's stock would not have been a "proper adjustment." We think there was substantial evidence to support such a conclusion.

The Government relies upon *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, for the proposition that losses of one year may not offset receipts of another year. But the case suggested its own distinction: "While [the money received] equalled, and in a loose sense was a return of, expenditures made in performing the contract, still, as the Board of Tax Appeals found, the expenditures

[30] General Counsel's Memorandum 20854, 1939-1 Cum. Bull. 102, following G. C. M. 18525, 1937-1 Cum. Bull. 80; revoked by G. C. M. 22163, 1940-2, Cum. Bull. 76. This dealt with bad debt recoveries.

were made in defraying the expenses. . . . They were not capital investments, the cost of which, if converted, must first be restored from the proceeds before there is a capital gain taxable as income." 282 U. S. at 363-64. It is also worth noting that the Court affirmed the Board's decision, which had been upset by the circuit court of appeals, and answered, in part, the contention of the circuit court that certain regulations were applicable by saying, ". . . nor on this record do any facts appear tending to support the burden, resting on the taxpayer, of establishing that the Commissioner erred in failing to apply them." 282 U. S. at 366-67.

It is argued on behalf of the Commissioner that the Court should overrule the Board by applying to this question rules of law laid down in decisions on the analogous problem raised by recovery of bad debts charged off without tax benefit in prior years. The court below accepted the argument. However, instead of affording a reason for overruling the Tax Court, the history of the bad debt recovery question illustrates the mischief of overruling the Tax Court in matters of tax accounting. Courts were persuaded to rule as matter of law that bad debt recoveries constitute taxable income, regardless of tax benefit from the charge-off.[31] The Tax Court had first made a similar holding,[32] but had come to hold to the contrary.[33] Substitution of the courts' rule for that of the Tax Court led to such hardships and inequities that the Treasury appealed to Congress to extend relief.[34] It did so.[35] The

[31] Commissioner *v.* United States & International Securities Corp., 130 F. 2d 894; Helvering *v.* State-Planters Bank & Trust Co., 130 F. 2d 44.

[32] Lakeview Trust & Savings Bank *v.* Commissioner, 27 B. T. A. 290.

[33] Central Loan & Investment Co. *v.* Commissioner, 39 B. T. A. 981; Citizens State Bank *v.* Commissioner, 46 B. T. A. 964.

[34] Mr. Randolph Paul, Tax Adviser to the Secretary of the Treasury, in a statement to the House Committee on Ways and Means said: "The Secretary has pointed out that wartime rates make it imperative to eliminate as far as possible existing inequities which distort the tax burden of certain taxpayers. I should like to discuss the inequities which the Secretary mentioned, as well as a few additional hardships. . . .

"(c) *Recoveries of bad debts and taxes.*—If a taxpayer who has taken a bad debt deduction later receives payment of such debt, such payment must be included in his income even though he obtained no tax benefit from the deduction in the prior year. While this result is theoretically proper under our annual system of taxation, it may produce severe hardships in certain cases through a distortion of the taxpayer's real income. At the same time, any departure from our annual system of taxation always produces administrative difficulties which serve to impede the collection of taxes.

"It is believed that the hardships can be removed and the administrative difficulties kept to a minimum by excluding from income amounts received in

Government now argues that by extending legislative relief in bad debt cases Congress recognized that in the absence of specific exemption recoveries are taxable as income. We do not find that significant in the amendment. A specific statutory exception was necessary in bad debt cases only because the courts reversed the Tax Court and established as matter of law a "theoretically proper" rule which distorted the taxpayer's income. Congress would hardly expect the courts to repeat the same error in another class of cases, as we would do were we to affirm in this case.[36]

The Government also suggests that "If the tax benefit rule were judicially adopted the question would then arise of how it should be determined," and the difficulties of determining tax benefits, it says, create "an objection in itself to an attempt to adopt such a rule by judicial action." We are not adopting any rule of tax benefits. We only hold that no statute or regulation having the force of one and no principle of law compels the Tax Court to find taxable income in a transaction where as matter of fact it found no economic gain and no use of the transaction to gain tax benefit. The error of the court below consisted of treating as a rule of law what we think is only a question of proper tax accounting.

There is some difference in the facts of these cases. In two of them the Tax Court sustained deficiencies because it found that the deductions in prior years had offset gross income for those years and therefore concluded that the recoveries must to that extent be treated as taxable gain.[37] The taxpayers object that this conclusion disregards certain exemptions and credits which would

payment of the debt to the extent that the deduction on account of the debt in the prior year did not produce a tax benefit. The troublesome question whether a benefit resulted should be determined pursuant to regulations prescribed by the Commissioner with the approval of the Secretary. It is also suggested that this treatment be extended to refunds of taxes previously deducted." Hearings before Committee on Ways and Means on Revenue Revision of 1942, 77th Cong., 2d Sess., Vol. I, 80, 87-88.

[35] Revenue Act of 1942 § 116, 56 Stat. 798, 812.

[36] The question of whether a recovery is properly accounted for as income in the year received or should be related to a previous reported deduction without tax benefit is one with a long history and much conflict. It arises not only in case of recoveries of previously charged off bad debts and recoveries of the type we have here. It is also present in case of refund of taxes or cancellation of expenses or interest previously reported as accrued, adjustments of depreciation and depletion or amortization, and other similar situations.

[37] John V. Dobson *v.* Commissioner, 46 B. T. A. 770.

have been available to offset the increased gross income in the prior years, so that the deductions resulted in no tax savings. In determining whether the recoveries were taxable gain, however, the Tax Court was free to decide for itself what significance it would attach to the previous reduction of taxable income as contrasted with reduction of tax. The statute gives no inkling as to the correctness or incorrectness of the Tax Court's view, and we can find no compelling reason to substitute our judgment. In No. 47 the decision of the Tax Court was upheld by the court below, and in that case the judgment is affirmed. In Nos. 44, 45, and 46, the Court of Appeals reversed the Tax Court, and for the reasons stated its judgments in those cases are

Reversed.

A true copy.

Test:

Clerk, Supreme Court, U. S.

SUPREME COURT OF THE UNITED STATES.

Nos. 44 and 47.—October Term, 1943.

John V. Dobson, Petitioner, 44 *vs.* Commissioner of Internal Revenue. H. J. Harwick, Petitioner, 47 *vs.* Commissioner of Internal Revenue.	On Writs of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

[February 14, 1944.]

Mr. Justice Jackson delivered the opinion of the Court.

Petition for rehearing in two of the four cases decided together on December 20, 1943 states that these contained an issue not present and not considered in the main case. In these two cases the Tax Court held that recoveries by these taxpayers in 1939 did constitute taxable income. It held, also, that the recovery was taxable as ordinary income, despite taxpayer's contention that it should be taxed as capital gain under Section 117 of the Internal Revenue Code. This contention, the petition says, presents questions of law to be determined by this Court, rather than of fact finally to be determined by the Tax Court.

The weakness of taxpayers' position lies in the fact that not every gain growing out of a transaction concerning capital assets is allowed the benefits of the capital gains tax provision. Those are limited by definition to gains from "the sale or exchange" of capital assets. Internal Revenue Code § 117(2), (3), (4), (5).

We certainly cannot say that the items in question were as matter of law proceeds of the "sale or exchange" of a capital asset. Harwick asserted a claim, and the three other taxpayers involved in these cases filed suit, against the National City Company, demanding rescission of their purchases of stock. Their claims were compromised or admitted; the taxpayers seek to link the recoveries resulting therefrom with their prior sales of the stock, which resulted in losses. The Tax Court did not find as matter of fact, and we decline to say as matter of law, that such a transaction is a "sale or exchange" of a capital asset in the

accepted meaning of those terms. Cf. *Helvering* v. *Flaccus Leather Co.*, 313 U. S. 247; *Fairbanks* v. *United States*, 306 U. S. 436. In *Helvering* v. *Hammel*, 311 U. S. 504; *Electro-Chemical Engraving Co.* v. *Commissioner*, 311 U. S. 513; *Helvering* v. *Nebraska Bridge Supply & Lumber Co.*, 312 U. S. 666, on which petitioner relies, we held as matter of law that losses resulting from a sale were not to be denied the benefits of the capital losses provisions because the sale was a forced or involuntary one, as upon foreclosure. Those cases are no aid to petitioner here.

Petition for rehearing is denied.

Mr. Justice DOUGLAS dissents.

A true copy.

Test:

Clerk, Supreme Court, U. S.